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1987 Survey of Recent Developments In Indiana Law

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Acknowledgement

The Board of Editors of the *Indiana Law Review* welcomes Dean Norman Lefstein to the Indiana University School of Law—Indianapolis. Dean Lefstein left his position as professor of law at the University of North Carolina to become Dean, effective January 1, 1988. After engaging in private practice in Chicago for several years, Dean Lefstein served as an Assistant United States Attorney, as a Project Director for the National Conference of Juvenile Court Judges, and as a staff attorney with the Deputy Attorney General of the United States. He has also served as Director of the Public Defender Service for the District of Columbia and has held visiting appointments at Duke University School of Law and Hebrew University in Jerusalem.

The Board of Editors would also like to acknowledge the work of Jeffrey W. Grove, who occupied the position of Acting Dean prior to Dean Lefstein's appointment. His leadership and dedication provided needed stability during a period of change at our school.

Board of Editors
Indiana Law Review

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Developments in Business Associations Law: CTS Corporation v. Dynamics Corporation of America

PAUL J. GALANTI*

There is definitely something to be said for persistence. Since 1975, Indiana, like a majority of states, has attempted to limit if not outright stop hostile corporate takeover attempts.[1] Most early state efforts to regulate hostile takeover attempts were blatantly pro-management and anti-offeror. As a result they were subject to serious constitutional challenge on two grounds: (1) they imposed an impermissible burden on interstate commerce and violated the commerce clause of the constitution,[2] or (2) they conflicted with the balanced approach to takeovers reflected in the Williams Act amendments[3] to the Securities Exchange Act of 1934[4] and were preempted by the federal statute under the supremacy clause.[5]

One of the earliest cases to consider the constitutionality of a state antitakeover statute invalidated the Idaho Business Takeover Act[6] on both grounds.[7] However, when that case reached the United States

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[1]IND. CODE §§ 23-2-3-1 to -12 (West Supp. 1975) (repealed 1979). The first Indiana Business Takeover Law was discussed in Galanti, *Business Associations, 1975 Survey of Recent Developments in Indiana Law*, 9 IND. L. REV. 33, 52-59 (1975) and Note, *The Indiana Business Takeover Act*, 51 IND. L. J. 1051 (1976).

[2]U.S. CONST. art. I § 8, cl. 3.

[3]15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982).

[4]15 U.S.C. § 78 (1982).

[5]U.S. CONST. art. VI, cl. 2.

[6]IDAHO CODE §§ 30-1501 to -1513 (Supp. 1979).

[7]Great W. United Corp. v. Kidwell, 439 F. Supp. 420 (N.D. Tex. 1971), *aff'd* 577 F.2d 1256 (5th Cir. 1978), *rev'd on other grounds sub nom.* Leroy v. Great W. United Corp. 443 U.S. 173 (1979).

Supreme Court[8] the Court did not reach the merits of the dispute. Rather it reversed because venue to challenge the validity of the Idaho statute as applied to an Idaho corporation was improper in the United States District Court for the Northern District of Texas.[9]

The Supreme Court eventually reached the merits of the first generation of state antitakeover statutes in *Edgar v. MITE Corp.*[10] In *MITE*, the Court held the Illinois Business Takeover Act[11] violated the commerce clause by placing an excessive indirect burden on interstate commerce. A plurality of the Court held that the Illinois act also violated the commerce clause by imposing a direct burden on interstate commerce.[12] Three justices thought the state law was preempted by the Williams Act.[13]

The rationale behind striking down the Illinois Act for imposing an improper indirect burden on commerce was that protecting shareholders, the avowed purpose of the statute, did not justify regulating tender offers to shareholders residing outside Illinois. In fact, the scheme of the Illinois Act could harm those shareholders because the delays permitted by the statute could help management defeat value increasing tender offers.[14]

The four justice plurality in *MITE* reasoned that the Illinois Act, by its terms, could have applied to tender offers in which no shareholder of the target company was a resident of Illinois. They also noted that if such statutes were adopted across the country, "interstate commerce in securities transactions generated by tender offers would be thoroughly stifled."[15]

The three justices,[16] who urged that the Williams Act amendments to the Securities Exchange Act of 1934 preempted the Illinois Business

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[8]Leroy v. Great W. United Corp., 443 U.S. 173 (1979).

[9]*Great Western*, 443 U.S. at 186-87.

[10]457 U.S. 624 (1982).

[11]Ill. Rev. Stat. ch.121 1/2, § 137.51 (1979).

[12]*MITE*, 457 U.S. at 641-43.

[13]*Id.* at 630-39. Justice White was joined by Chief Justice Burger and Justice Blackmun on this issue. Three justices believed the case was moot, *id.* at 655-64 (Marshall, J., dissenting), and one believed that it failed to present a justiciable controversy. *Id.* at 664-67 (Rehnquist, J., dissenting).

[14]*Id.* at 644. *See generally* Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161, 1174-82 (1981).

[15]*MITE*, 457 U.S. at 642 (White, J., Burger, C.J., Powell and O'Connor, J.J.). The original Indiana Takeover Act, Ind. Code §§ 23-2-3-1 to -12 (West Supp. 1975) (repealed 1979) also had such extraterritorial scope. *Id.* § 23-2-3-1(j). *See* Galanti, *Corporations, 1979 Survey of Recent Developments in Indiana Law*, 13 Ind. L. Rev. 133, 161-72 (1980); Galanti, *Business Associations, 1975 Survey of Recent Developments in Indiana Law*, 9 Ind. L. Rev. 33, 53-59 (1975); Note, *The Indiana Business Takeover Act*, 51 Ind. L.J. 1051 (1976).

[16]*MITE*, 457 U.S. at 630-34 (White, J., Burger, C.J. and Blackmun, J.).

Takeover Act, accepted the fact that the Exchange Act itself permits states to regulate securities as long as the regulations do not conflict with the Act itself.[17] They also recognized that it was possible for a tender offer to comply with both federal and state law. However, Justice White argued the Illinois statute frustrated the two primary objectives of the Williams Act: shareholder protection and a balancing of the interests of management, offerors, and targets.[18] "Congress sought to protect the investor not only by furnishing him with the necessary information but also by withholding from management . . . any undue advantage that could frustrate the exercise of an informed choice."[19] In other words, the intent of the Williams Act was to establish a level playing field[20] and any state effort to "tilt" the balance towards management had to fall under the supremacy clause.[21]

The original Indiana Business Takeover Act was superseded in 1979 by the Indiana Takeover Offers Act.[22] The constitutionality of this statute never has been resolved completely. The validity of the statute was challenged in *City Investing v. Simcox*.[23] The court purportedly abstained from deciding the validity issue because there was some question whether the purchase of shares by the plaintiff was a takeover offer within the meaning of the act. Under the so-called *Pullman* abstention doctrine originally articulated by Justice Frankfurter in *Railroad Commission v. Pullman*[24] federal courts will refrain from prematurely deciding constitutional issues pending determination in state courts of state law issues central to the constitutional dispute.[25]

As courts are sometimes wont to do, after determining it did not have to resolve plaintiff's challenge in the Takeover Offers Act, the District Court in *Simcox* went to the "merits" and held the statute was valid. The court, however, only reached conclusions and did not discuss to any great extent the constitutional grounds for invalidating state

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[17]*MITE* 457 U.S. at 630-31 (citing 15 U.S.C. § 78bb(a) (1982)).

[18]*MITE*, 457 U.S. at 631-34.

[19]*Id.* at 634.

[20]*See* Piper v. Chris-Craft Indus., 430 U.S. 1, 26-34 (1977).

[21]*MITE*, 457 U.S. at 632-34.

[22]Ind. Code §§ 23-2-3.1-1 to -11 (Supp. 1987). *See* Galanti, *Corporations, 1979 Survey of Recent Developments in Indiana Law*, 13 Ind. L. Rev. 133, 161-72 (1980).

[23]476 F. Supp. 112 (S.D. Ind. 1979), *aff'd*, 633 F.2d 56 (7th Cir. 1980).

[24]312 U.S. 496 (1941).

[25]*Id. See* Moore v. Sims, 442 U.S. 415 (1979). There are two other species of abstention in addition to *Pullman* abstention: (1) *Burford* abstention where federal courts relegate federal issues to state courts because those issues touch matters of traditional state concern, *see* Burford v. Sun Oil Co., 319 U.S. 315, 317-18 (1943); and (2) *Younger* abstention where federal courts abstain from interfering with state criminal prosecutions out of deference for state functions. *See* Younger v. Hams, 401 U.S. 37, 44 (1971).

antitakeover statutes raised in *Great Western* and *MITE*.[26] The decision in *Simcox* was affirmed by the Seventh Circuit on the basis of the *Pullman* doctrine[27] without getting to the merits.[28]

The wisdom of the Seventh Circuit in *Simcox* was borne out by the Indiana Court of Appeals in *In re City Investing Co.*[29] when it reversed the Indiana Securities Commissioner's cease and desist order against the offeror. As anticipated by the Seventh Circuit, the Indiana court concluded the purchase of the target's shares was not a takeover offer within the meaning of the Act.[30] The court rejected the state's contention that the Takeover Offers Act was intended to regulate all shifts in corporate control through stock purchases, and not just tender offers, as being "overbroad and contrary to the plain language of the Act."[31] A "takeover offer" is not limited to conventional tender offers, but the term has an established legal significance. The court presumed that the legislature intended the term to be given its customary legal meaning in the Act absent any indication to the contrary.[32] The definition of takeover offers in the Takeover Offers Act is similar to that found in section 14(d) of the Williams Act.[33] Consequently, the *City Investing* court concluded that takeover offers regulated by the Indiana Act are those offers to acquire the equity securities of "a company pursuant to that which is regulated by the Williams Act . . . ."[34]

There was a shift away from using blunderbuss antitakeover statutes typified by the Illinois statute invalidated in *MITE* in the early 1980's. Because those statutes attacked the tender offer itself they invited challenge on Williams Act preemption and commerce clause grounds. Those concerned with hostile takeovers realized that the primary concern of antitakeover statutes should be the interests of shareholders because it is they who stand to lose if "unfair" tender offer practices continue.[35]

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[26]476 F. Supp. at 115.

[27]633 F.2d 56, 60 (7th Cir. 1980).

[28]However, there was little doubt as to the Seventh Circuit's view on the merits. On the same day *Simcox* was decided the court invalidated the Illinois Business Takeover Act in MITE Corp. v. Dixon, 633 F.2d 496 (1980), *aff'd sub nom.* Edgar v. MITE Corp., 457 U.S. 624 (1982).

[29]411 N.E.2d 420 (Ind. Ct. App. 1980).

[30]*Id.* at 432.

[31]*Id.* at 426.

[32]*Id.* at 427.

[33]15 U.S.C. § 78n(d)(1) (1982).

[34]*City Investing*, 411 N.E.2d at 427.

[35]Concerned parties include management of potential target companies, fearful of losing jobs, and state and local officials fearful of losing corporate home offices to other states. These are certainly legitimate concerns. Whether they should stand in the way of a free market for corporate control is an entirely different matter. Others are simply

Of course, it is also the shareholders who stand to lose if management is able to thwart a tender offer carrying a premium over the then market price of the target's shares.

Thus the focus of antitakeover efforts began to shift. Changes were made to existing antitakeover statutes ranging from self-serving statements that the purpose of the statute is to ensure that shareholders can make an "informed and well-reasoned investment decision"[36] to provisions requiring takeover offers to be made to all shareholder-offerees of the same class on substantially equivalent terms[37] to provisions limiting subsequent acquisition of equity securities by an offeror following the conclusion of a takeover offer.[38]

Current efforts to block hostile takeover attempts also are found in general corporation statutes. For example, the Indiana Business Corporation Law[39] contains two chapters intended to regulate "change of control transactions": the Control Share Acquisition Chapter[40] and the Business Combinations Chapter.[41]

The Control Share Acquisition Chapter does not on its face prohibit the acquisition of shares either pursuant to a tender offer or in market transactions. Rather it limits the voting rights of such shares unless independent shareholders, (shareholders other than the acquiring shareholder, an officer of the target company or an employee-director of the target company),[42] adopt a resolution granting the right to vote to the bidder.[43] The statutory provisions are triggered whenever a person acquires shares that raise total holdings over a "control share" threshold—20, 33 1/3, or 50 percent of outstanding shares.[44] The acquiring shareholder can request management of the target company to submit to the shareholders within fifty days the issue of the right of the acquiring shareholder

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troubled by the practices and financing methods used by persons and companies aggressively active in the tender offer "game," "corporate raiders" as it were. These, too, are certainly legitimate concerns. Whether they should be addressed at the state level where theoretically 50 different rules can apply to a tender offer or at the federal level because the companies affected as offerors or targets will have facilities and shareholders in many states also is an entirely different matter.

[36]This provision was added to the Indiana Business Takeover Offers Act in 1981. IND. CODE § 23-2-3.1-0.5(b) (Supp. 1987).

[37]This provision was added to the Indiana Business Takeover Offers Act in 1983. *See* IND. CODE § 23-2-3.1-6-5 (Supp. 1987).

[38]*Id.*

[39]IND. CODE §§ 23-1-17-1 to -54-2 (Supp. 1987).

[40]IND. CODE §§ 23-1-42-1 to -11 (Supp. 1987).

[41]IND. CODE §§ 23-1-43-1 to -24 (Supp. 1987).

[42]*See* IND. CODE § 23-1-42-3 (Supp. 1987). Outside directors of the target company are considered "non-interested" under the statute.

[43]*Id.* 23-1-42-9.

[44]IND. CODE § 23-1-43-1 (Supp. 1987).

to vote the acquired shares.[45] If no request for a special meeting is made, the issue of voting rights is considered at the next special or annual shareholder meeting.[46]

If authority existed in the target's articles of incorporation or bylaws in advance of the control share acquisition, and the acquiring shareholder does not timely file an acquiring person's statement, the target can redeem at a fair value the shares acquired within a period of sixty days following the last acquisition of shares.[47] If the acquiring shareholder makes a request for a meeting, its shares can only be redeemed in the event that the independent shareholders deny full voting rights.[48] If the shareholders grant the bidder full voting rights and the acquiring shareholder has thereby acquired a majority of all voting power, shareholders who have exercised dissenters' rights of appraisal can receive fair value of their shares.[49]

The Business Combinations Chapter of the Indiana Business Corporation Law (IBCL)[50] purports to protect unsophisticated investors, as compared to sophisticated investors such as arbitragers, from the undesirable effects of a hostile tender offer. These effects result from either tendering too quickly and not getting the full benefits of the offer or not tendering at all and being the victim of an unfair "freeze out" at the end of a successful takeover.[51]

Under the Business Combinations Chapter an offeror who has acquired in excess of ten percent of the outstanding voting securities of a "resident domestic corporation" or any subsidiary[52] is prohibited from engaging in a merger or any of an enumerated list of transactions with the target company[53] for a period of five years following the acquisition

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[45]Ind. Code § 23-1-42-7(b) (Supp. 1987). The acquiring shareholder must give an undertaking to pay the expenses of the special meeting. *Id.* § 23-1-42-7(a).

[46]Ind. Code § 23-1-4-7(c) (Supp. 1987).

[47]Ind. Code § 23-1-42-10(a) (Supp. 1987). The chapter defines "fair value" as a value not less than the highest price paid per share by the acquiring person in the control share acquisition. *Id.* § 23-1-42-11(c).

[48]*Id.* § 23-1-42-10(b).

[49]*Id.* § 23-1-42-11.

[50]*Id.* § 23-1-43-1 to -24.

[51]*See* Strain, *Provisions Affecting Change of Control Transactions in the New Indiana Business Corporation Law*, ICLEF New Indiana Business Corporation Law Seminar VII-4 to VII-7 (1986). It is interesting to note that the drafters of antitakeover legislation such as that found in the IBCL tend to think in terms of unfair freezeouts by hostile tender offerors and ignore the possibility of unfair freezeouts by management leveraged buy outs.

[52]Ind. Code § 23-1-43-10(a) (Supp. 1987). A resident domestic corporation is defined as "a corporation that has one hundred (100) or more shareholders." *Id.* § 23-1-43-13(a). A resident domestic corporation does not cease to be one because of events occurring or actions taken while subject to the chapter. *Id.* § 23-1-43-13(b).

[53]*Id.* § 23-1-43-5.

of the shares.[54] After that time, a transaction can occur if it either results in a fair price to the independent shareholders, as defined in the statute, or is done pursuant to the affirmative vote of a majority of the independent shareholders.[55]

Interestingly, the five year delay does not apply if the business combination or the purchase of shares made by the acquiring shareholder is approved by the board of directors of the corporation before the shares are acquired.[56] Equally interesting, business combinations approved by the board of directors of the corporation before the shares are acquired or implemented by means of shares acquired with the prior approval of the board of directors are permitted without a vote of a majority of the independent shareholders and without satisfying the fair price requirement.[57] In other words, deals favored by management are exempt regardless of their impact on shareholders.

The consideration to which shareholders of the target are entitled is the highest price paid by the acquiror for the shares that gave rise to the control position plus an interest add-on over the period tied to the one-year treasury bill rate.[58] Theoretically this gives shareholders of Indiana corporations the option of riding with the new owners, knowing in advance what their floor will be at the end of five years. Those who otherwise would have been frozen out for paper or something less than fair consideration for their shares are protected.[59] Unless, of course, it is a deal favored by management. A favored deal may bring the highest price to shareholders[60] but that depends on the sincerity of management's interest in shareholders as opposed to their interest in their own jobs.[61]

The adoption of the Business Combinations chapter was such a high priority of the 1986 session of the General Assembly that it received the honor of being Senate Bill No. 1[62] as well as being chapter 43 of the later enacted IBCL. It became effective on January 23, 1986, and applied to Indiana corporations unless they "opted" out by an amendment to the corporation's by-laws by February 1, 1986.[63] The Business

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[54] *Id.* § 23-1-43-18(a).

[55] *Id.* § 23-1-43-19(2).

[56] *Id.* § 23-1-43-18(a).

[57] *Id.* § 23-1-43-19(1).

[58] *Id.* § 23-1-43-19(3).

[59] *See* Strain, *supra* note 51, at VII-5, VII-6.

[60] *Id.* at VII-6.

[61] History shows that management of target companies acquired in a hostile takeover do not remain employed by the target for very long.

[62] IND. CODE § 23-2-9-1 to -22 (Supp. 1986). This statute was repealed effective August 1, 1987, which was the effective date of the IBCL.

[63] IND. CODE § 23-3-9-22(3)(B) (repealed) (Supp. 1987). It is possible, though unlikely because of the interest of management of corporations that were, or were potential, targets

Combination Act was challenged in one attempted takeover of an Indiana corporation, but the issue was mooted when the proposed acquisition was held to violate the federal antitrust law.[64]

The challenge to the Control Share Acquisition Chapter of the IBCL, on the other hand, went all the way to the United States Supreme Court in *CTS Corp. v. Dynamics Corporations of America.*[65] Dynamics Corporations of America's (DCA) attempt to obtain control of CTS was a prolific generator of legal issues and judicial decisions: one in the Indiana Court of Appeals,[66] three in the United States District Court for the Northern District of Illinois,[67] one in the Seventh Circuit Court of Appeals,[68] and one in the United States Supreme Court.[69] The Supreme Court's decision resulted in three separate opinions.[70]

The most important of the lower court opinions was Judge Posner's opinion in the Seventh Circuit[71] holding that the Control Share Acquisition provisions of the IBCL violated both the supremacy and commerce clauses of the United States Constitution.[72] Judge Posner first discussed

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of hostile takeover attempts, that corporations might not have learned of Senate Bill No. 1 until after the opt out period had elapsed.

[64]Laidlaw v. Mayflower Group, 636 F. Supp. 1513 (S.D. Ind. 1986).

[65]107 S.Ct. 1637 (1987).

[66]Dynamics Corp. of America v. CTS Corp., 479 N.E.2d 1352 (Ind. Ct. App. 1985).

[67]Dynamics Corp. of America v. CTS Corp., 637 F. Supp. 406 (N.D. Ill. 1986); Dynamics Corp. of America v. CTS Corp., 635 F. Supp. 1174 (N.D. Ill. 1986); Dynamics Corp. of America v. CTS Corp., Fed. Sec. L. Rep. (CCH) ¶ 92,765 (N.D. Ill. May 3, 1986).

[68]Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir. 1986).

[69]107 S.Ct. 1637 (1987).

[70]Justice Powell delivered the opinion of the Court, in which Chief Justice Rehnquist, and Justices Brennan, Marshall, and O'Connor joined. Justice Scalia joined in Parts I, III-A, and III-B, of the majority's opinion and filed an opinion concurring in part and concurring in the judgment. Justice White filed a dissenting opinion, in Part II of which Justices Blackmun and Stevens joined.

[71]794 F.2d 250 (7th Cir. 1986).

[72]Judge Posner also affirmed the decision in Dynamics Corp. of America v. CTS Corp., 637 F. Supp. 406 (N.D. Ill. 1986) enjoining CTS's management from enforcing a "poison pill" plan adopted by CTS during a proxy contest between management and DCA. DCA sought injunctive relief under section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(a) (1982), alleging an unlawful proxy solicitation by CTS management, 637 F. Supp. at 407.

Judge Posner was not impressed with the poison pill as a plausible measure for maximizing shareholder wealth. He conceded that it was not certain CTS shareholders, other than DCA, would be worse off if the pill was triggered, but he felt it was too high a price to pay for preventing a shift in control from incumbent CTS management to DCA. DCA could not have squeezed out remaining shareholders because it would not own a majority of shares even if the tender offer succeeded. A *reasonable* defensive move would have been a device that would be triggered by a transaction creating a majority shareholder or an attempt to squeeze out minority shareholders in an unfair transaction.

the supremacy clause issue: was the Control Share Acquisition chapter preempted by the Williams Act?[73] He characterized the statute as "cleverly drafted . . . to skirt judicial holdings that forbid states to delay tender offers beyond the period required by the Williams Act."[74] The effect of the statute as he perceived it was to impose a fifty day delay on tender offers at the option of the target. This made it more difficult for any tender offer to succeed because an offeror could not accept tendered shares until the shareholder meeting where it will be determined if the shares will carry voting rights. Thus a tender offer would have to be kept open for fifty days rather than the twenty business days required by SEC Rule 14e-1(a),[75] and even then the offeror cannot be certain of a victory because the "disinterested" shareholders must approve the vote.[76]

Judge Posner reasoned that even though the *MITE* Court did not accept the preemption argument, it held that Congress intended to strike a balance between target management and offerors in the Williams Act.[77] From this premise courts have reasoned that states may not upset the balance struck by Congress.[78] To Judge Posner, the Williams Act does exist and it does strike a balance.[79] Regardless of whether the balance is proper or desirable as an economic matter, Congress probably did not want the states to tip the "balanced playing field" one way or the other. The Indiana statute might be less offensive than the statute in *MITE*, but the fifty day period was still "too much."[80]

Even if the Control Share Acquisition Chapter could survive a preemption challenge, Judge Posner made it clear that it would still fall under the commerce clause. The commerce clause invalidates state regulation of interstate commerce that conflicts with the presumed purpose

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794 F.2d 250, 254-59.

Judge Posner drolly turned one CTS argument against itself: If a DCA controlled board of directors of CTS could "gull" the remaining shareholders, then corporate management cannot be trusted to protect the interest of shareholders. 794 F.2d at 259.

[73]15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982).

[74]794 F.2d at 261.

[75]SEC Rule 14e-1(a); 17 C.F.R. § 240.14e-1(a) (1986).

[76]794 F.2d at 261. One possible unforeseen consequence of a statute like the Control Share Acquisition Chapter is that it might tempt offerors to put an offer into play where management owns a substantial number of shares knowing that management will be disenfranchised. In fact a Minnesota corporation was forced into the arms of a white knight for this reason after Minnesota adopted at the behest of the Dayton-Hudson Corporation, an antitakeover statute similar to the Control Share Acquisition Chapter.

[77]794 F.2d at 262. *See* Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977).

[78]*See, e.g.*, Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558, 567-68 (6th Cir. 1982); National City Lines, Inc. v. LLC Corp., 687 F.2d 1122, 1128-33 (8th Cir. 1982).

[79]*Dynamics Corp.*, 794 F.2d at 262.

[80]*Id.*

of the clause to make the nation a common market, at least where Congress has not spoken.[81] *MITE* and other cases separate the supremacy and the commerce clauses and assume that the commerce clause retains an independent force notwithstanding the enactment of the Williams Act.[82] In this respect, Judge Posner, in *Dynamics*, stated there was no indication the Williams Act was intended to insulate antitakeover statutes from complaints that they unduly burden interstate commerce.[83]

The commerce clause does not bar all state action that might impose some burden on interstate commerce. Statutes will be upheld if local benefits exceed the burden imposed in interstate commerce.[84] Applying this test, Judge Posner concluded the burdens the Control Share Acquisition Chapter inflicted on nonresidents exceeded the benefits to Indiana residents. He assumed that the vast majority of DCA or CTS shareholders were not Indiana residents. Consequently the statute gravely impaired DCA's ability to do business with those shareholders. Or as he phrased it, "Indiana has no interest in protecting residents of Connecticut from being stampeded to tender their shares to Dynamics at $43."[85] He also stated, "For the sake of trivial or even negative benefits to its residents Indiana is depriving nonresidents of the valued opportunity to accept tender offers from other nonresidents."[86] He even doubted if any appreciable number of Indiana shareholders would benefit from the statute and stated that the only beneficiaries might be the officers and directors of CTS.[87] In essence Indiana was attempting to opt out of the interstate and international market for corporate control, an effort barred by the commerce clause.

The Seventh Circuit rejected CTS's argument that Indiana should be permitted to control the "internal affairs" of Indiana corporations.[88] Judge Posner, of course, recognized that Indiana has broad latitude in regulating internal affairs of Indiana corporations. This includes the right to authorize provisions in corporate documents that discourage takeovers.[89] However, he concluded there are limits to the internal affairs

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[81]*Id.* at 263. *See* Cooley v. Board of Wardens, 53 U.S. 249 (1852).

[82]*Dynamics Corp.*, 794 F.2d at 263. *See* Edgar v. MITE Corp., 457 U.S. 657 (1982).

[83]*Dynamics Corp.*, 794 F.2d at 263.

[84]*See* Pike v. Bruce Church, Inc., 397 U.S. 137 (1970). A majority of the Court in *MITE* found that the Illinois statute violated the commerce clause as an undue, indirect burden on interstate commerce. Edgar v. MITE Corp., 457 U.S. 624, 640-46 (1982).

[85]*Dynamics Corp.*, 794 F.2d at 263.

[86]*Id.* at 264.

[87]*Id.*

[88]*Id.*

[89]*Id.* The court referred to cumulative voting, which can make it difficult to oust an entire existing board of directors. A staggered board of directors would also be permitted even though it was a defensive move by management. *Id.*

doctrine, which are exceeded when the state regulation has an effect "on the interstate market in securities and corporate control [that] is direct, intended and substantial . . . [and] not merely the incidental effect of a general regulation of internal corporate governance."[90] As Judge Posner accurately, if not elegantly, phrased it, the Control Share Acquisition Chapter is an explicit regulation of tender offers and is not immunized from the commerce clause because "the mode of regulation involves jiggering with voting rights. . . ."[91] It was primarily on the "internal affairs doctrine" that the Supreme Court reversed the Seventh Circuit.[92] The Court, of course, discussed both grounds relied on by the lower courts in striking down the Indiana statute. Justice Powell, writing for the majority, first discussed the Williams Act preemption issue, and concluded that because it is entirely possible for entities to comply with both the Williams Act and the Indiana Act, the state statute can be preempted only if it frustrates the purposes of the federal law.[93]

It is interesting that the majority did not reject the preemption test outright. Rather it assumed that such a test might be appropriate but that the Control Share Acquisition Chapter passed muster because it did not tilt unduly the playing field towards target management. It just gave "shareholders the power to deliberate collectively about the merits of tender offers."[94] The Court examined the delay inherent in consummating tender offers until after the shareholder vote; discussed and seemingly authorized contingent tender offers;[95] and expressed concern that invalidating the Control Share Acquisition Chapter on a preemption ground would cast doubt on the validity of other aspects of state corporate law that might delay a control transaction.[96] The Court noted that "[t]he desire of the Indiana Legislature to protect shareholders of Indiana corporations from this type of coercive offer does not conflict with the Williams Act. Rather, it furthers the federal policy of investor protection."[97]

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[90]*Id.*

[91]*Id.*

[92]CTS Corp. v. Dynamics Corp. of America, 107 S.Ct. 1637, 1646-52 (1987).

[93]*Id.* at 1644-48, *citing* Ray v. Atlantic Richfield Co., 435 U.S. 151, 158 (1978).

[94]*CTS*, 107 S.Ct. at 1646 n.7.

[95]*Id.* at 1647 n.8.

[96]*Id.* at 1647. However, it really does not follow automatically that invalidating state antitakeover legislation would invalidate traditional corporate law concepts such as staggered boards and cumulative voting. After all, as Judge Posner pointed out, the Control Share Acquisition Chapter was intended to delay and hinder takeovers whereas provisions such as cumulative voting and staggered boards serve other purposes, and have for many years, even though they may delay an offeror from getting immediate control of a board of directors. The delay would be "merely the incidental effect of a general regulation of internal corporate governance." Dynamics Corp., 794 F.2d at 264.

[97]*CTS*, 107 S.Ct. at 1646.

This might be true, but Justice Powell's opinion does not reflect the fact, as reported in The Wall Street Journal, that the Chairman of Arvin Industries had asked the President of the Indiana Senate to:

> "help stop . . . [a threatened] takeover and save Arvin Industries and Columbus from wrenching change, [and that the President of the Senate] didn't let him down. Within four weeks, he had steered a tough anti-takeover bill, drafted by Arvin's own lawyers, through the Indiana Legislature and onto the governor's desk, where it was promptly signed. The bill, in effect, outlawed most hostile takeovers in the Hoosier State.[98]

One scholar has observed that Williams Act preemption scrutiny of various types of state regulation is still possible after *CTS*, but that "[w]hether the preemption bar will come down on statutes equally voluntary but authorizing a different constraint such as a 'fair price put' for remaining shareholders, or substantively like Indiana's but mandatory, is not clear."[99] It is possible, but perhaps unlikely considering the "tone" of the majority opinion. The majority did not flatly reject preemption in the takeover area, but certainly the opinion cannot be called sympathetic to preemption, short of instances where compliance with the Williams Act and state antitakeover statutes "is a physical impossibility."[100]

The majority's resolution of the commerce clause issue in *CTS* started from the premise that "[t]he principal objects of dormant Commerce Clause scrutiny are statutes that discriminate against interstate commerce."[101] The Control Share Acquisition Chapter was deemed "nondiscriminatory" because it applies to offerors whether or not domiciliaries or residents of Indiana. It rejected Dynamics' argument that it was discriminatory because most hostile tender offers will be launched by non-Indiana offerors: "[b]ecause nothing in the Indiana Act imposes a

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[98]Wall St. J., July 1, 1987, at 1, col.6. This was Senate Bill No. 1. The same article quoted an official at the Columbus Chamber of Commerce that the focus of an out-of-town owner "is on the bottom line and the return to shareholders." *Id.* p.14, col. 1. So much for protection of investors. It really is a legitimate question to ask just whose interests are being protected by antitakeover statutes such as the Control Share Acquisition Chapter. The statute might be couched in terms of shareholder action, but shareholders do not seem to have been the primary beneficiaries of Senate Bill No. 1.

[99]Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 Calif. L. Rev. 29, 31 (1987).

[100]*CTS*, 107 S.Ct. at 1644.

[101]*CTS*, 107 S.Ct. at 1648. *See, e.g.*, Lewis v. BT Invest. Managers, Inc., 447 U.S. 27, 36-37 (1980); Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978). *See generally* Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 Mich. L. Rev. 1091 (1986).

greater burden on out-of-state offerors than it does on similarly situated Indiana offerors, we reject the contention that the Act discriminates against interstate commerce.''[102]

One criticism of decisions such as Judge Posner's is that they tend to raise the ''free market'' school to a constitutional status. However, the Court's analysis of the commerce clause can be criticized because it comes ''dangerously close to embedding another doctrine—the 'state of incorporation' version of the internal affairs doctrine—in the Constitution via the same clause.''[103]

Justice Powell concluded that the Seventh Circuit's holding that the Control Share Acquisition Chapter was invalid because it hinders tender offers ignored the fact that states as overseers of corporate governance, enact laws that necessarily affect certain aspects of interstate commerce, particularly with respect to corporations with shareholders in other states.[104] He notes that ''[a] state has an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors have an effective voice in corporate affairs.''[105] The Indiana statute, accordingly, validly furthered these interests by allowing shareholders collectively to determine whether a takeover is advantageous to them. Justice Powell rejected the argument that Indiana has no legitimate interest in protecting nonresident shareholders because the Control Share Acquisition Chapter applies only to corporations incorporated in Indiana that have a substantial number of shareholders in the state.[106]

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[102]*CTS*, 107 S.Ct. at 1649. Of course this is something like saying that the law does not discriminate against the poor because the law in all its majesty prohibits both the rich and the poor from sleeping under bridges.

[103]Buxbaum, *supra* note 99, at 34-35. Professor Buxbaum did deem it laudable that the Court used the internal affairs doctrine to avoid raising efficient-capital and control-market hypotheses to the level of constitutional doctrine via the dormant commerce clause, as *MITE* and Judge Posner seemed to be doing. *Id.* at 34.

[104]*CTS*, 107 S.Ct. at 1649-50. For example mergers may require super-majority approval or dissenting shareholders may have appraisal rights.

[105]107 S.Ct. at 1651.

[106]*Id.* 107 S.Ct. at 1651-52. The Control Share Acquisition Chapter applies to publicly held corporations that have:

(1) one hundred (100) or more shareholders:

(2) its principal place of business, its principal office, or substantial assets within Indiana; and

(3) either:

(A) more than ten percent (10%) of its shareholders resident in Indiana;

(B) more than ten percent (10%) of its shares owned by Indiana residents; or;

(C) ten thousand (10,000) shareholders resident in Indiana.

Ind. Code § 23-1-42-4(a) (Supp. 1987).

There is something deliciously ironic in characterizing the Control Share Acquisition Chapter of the IBCL as being protective of the interests of shareholders of Indiana corporations. Most modern "flexible" corporation statutes have cut back the role and rights of shareholders in favor of management control of corporate affairs. This observation is particularly true with respect to the IBCL when the provisions of the Indiana statute are compared with the provisions of the Revised Model Business Corporation Act on which it is based.[107]

The Court in *CTS* refused to take sides in the debate over the merits or demerits of tender offers.[108] Rather it deferred to the empirical judgment of lawmakers.[109] This is a rather clear rejection of the "free market" approach to corporate regulation.[110] Perhaps there would be something wrong with a "federal regime that relies solely on 'the market' to regulate these structural phenomena [which] is cold comfort to local political units called upon to bear the costs of economic change today while the greater benefits of tomorrow manifest themselves elsewhere."[111] Of course, one might wonder just how sincere states and local political units are about "preserving" corporate presence and rank and file jobs. It is not unusual to pick up The Wall Street Journal to read about states adopting an antitakeover statute similar to Indiana's and also read about state efforts to woo businesses to relocate within their borders by means of tax abatements, other subsidies, a nonunion work force or even low worker's compensation costs. Few states, not including Indiana, can boast they do not engage in the game of "beggar thy neighbor."[112]

Justice Scalia joined with the majority on the commerce clause issue.[113] In fact his concurring opinion will bring pleasure to those openly

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[107]*See* 1-4 Model Bus. Corp. Act Ann. (3d ed. 1985).

[108]*CTS*, 107 S.Ct. at 1651-52 and n.12.

[109]*Id.* at 1651.

[110]*See generally* Easterbrook & Fishel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161 (1981).

[111]Buxbaum, *supra* note 99, at 32. *See generally* Stewart, *Pyramids of Sacrifice? Problems of Federalism in Mandating State Implementation of National Environmental Policy*, 86 Yale L. J. 1196 (1977).

[112]The *CTS* majority did not resolve CTS's argument that the Control Share Acquisition Chapter "does not violate the Commerce Clause—regardless of any burdens it may impose on interstate commerce—because a corporation's decision to be covered by the Act is purely 'private' activity beyond the reach of the Commerce Clause" 107 S.Ct. at 1652 n.14. This "contractarian" distinction might become more important or at least in issue, if, as is likely, states are pressured for still more vigorous antitakeover devices than are permitted by *CTS*. *See* Buxbaum, *supra* note 99, at 56. Of course, the question may very well be mooted if the number of hostile tender offers decrease because of the stock market crash of 1987.

[113]*CTS*, 107 S.Ct. at 1652-53 (Scalia, J., concurring).

favoring management in the takeover game since he says, "Nothing in the Constitution says that the protection of entrenched management is any less important a 'putative local benefit' than the protection of entrenched shareholders. . . ."[114] Justice Scalia can be commended in apparently recognizing that statutes such as the Indiana Control Share Acquisition Chapter are the result of pressure from managements threatened by hostile takeovers: Arvin in Indiana; Gillette Company in Massachusetts; Ashland Oil in Kentucky; Dayton-Hudson in Minnesota; Burlington Industries in North Carolina.[115] It is very telling that as the state of incorporation of a target, Delaware—a state which is as likely to be the state of incorporation of an offeror—has not followed Indiana's lead and, at least at present, has decided against a law curbing takeovers.[116] The refusal of the state with the most to lose if corporations flee to Indiana, or other states with similar or stronger antitakeover statutes, to adopt an antitakeover statute says something about the wisdom of antitakeover devices that are mandated by statute rather than adopted by shareholder actions.[117]As one observer has noted:

> [G]iven the ready availability of self-help what need is there for a statute? While a statute certainly saves the cost of a shareholder vote for firms that would otherwise voluntarily adopt such a provision, one cannot help but suspect that managers gripped by fear of losing their jobs lobby for legislation because they worry that a majority of their firm's shareholders would not approve a charter amendment.[118]

Of course, it was Justice Scalia who said that a "law can be both economic folly and constitutional."[119]

Justice Scalia departed from the majority on the Williams Act preemption issue, although he too agreed the Control Share Acquisition Chapter was not preempted. Rather than debating the purposes of the

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[114]*Id.* at 1653.

[115]*See* Goodman, *State Takeover Legislation*, 1 Insights No. 3 at 2 (Sept. 1987). *See also* State vs. Raiders: Will Washington Step In?, Bus. Wk. (August 31, 1987) at 56.

[116]Wall St. J., June 16, 1987, at 4, col. 4. *See also* Black, *Why Delaware is Wary of Anti-Takeover Law*, Wall St. J., July 10, 1987, at 16, col. 3. Mr. Black in his editorial piece raised the interesting point that the Control Share Acquisition Chapter provides a ready means of putting a company into play, certainly something not intended by the drafters of the statute.

[117]*See* Romano, *State Takeover Laws: Constitutional but Dumb*, Wall St. J., May 14, 1987, at 22, col. 4.

[118]*Id.* Shareholders may vote on whether to give voting rights to acquired control shares, but they vote on opting out of the statutory scheme only if management presents the decision to them. *See* Ind. Code § 23-1-42-5 (Supp. 1987).

[119]*CTS* Corp. v. Dynamics of America, 107 S.Ct. at 1654 (1987).

two statutes, Justice Scalia relied on section 28(a), the antipreemption provision of the Securities Exchange Act of 1934.[120]

He recognized that section 28(a) did not literally apply to the Control Share Acquisition Chapter, but read it extremely broadly as applying to any corporate statute and not just state blue sky laws.[121] Under Justice Scalia's approach preemption is foreclosed on the basis of a "conflicting purpose" and only applies when there is a "conflicting provision."[122]

Justice White wrote a dissenting opinion in *CTS* asserting that the Indiana statute is both preempted by the Williams Act and conflicts with the commerce clause.[123] He maintained, as he did for the plurality in *MITE*,[124] that the purpose of the Williams Act was to ensure the individual investors are given sufficient information so they can make an informed choice on whether to tender their shares in response to a tender offer. The problem he saw with the approach of the *CTS* majority was that it equates protection of individual investors, the focus of the Williams Act, with the protection of shareholders as a group.[125] The statute might help protect the interests of a majority of the shareholders in any corporation but in many instances it could effectively prevent an individual investor from selling his or her stock at a premium.[126] Consequently, it does not "furthe[r] the federal policy of *investor* protection," and so should fall under the supremacy clause.

One particularly telling point raised by Justice White is that the Control Share Acquisition Chapter is not simply a regulation of "shareholder voting rights" as characterized by proponents of the statute. Rather it is *transactional* in nature designed to thwart certain takeovers.[127] If this distinction is kept in mind, then the perceived threat preemption poses to other corporate control provisions such as cumulative voting and staggered boards is nothing more than a red herring.

On the commerce clause issue, Justice White concluded that the Court should not countenance a statute that effectively precludes a prospective purchaser from purchasing a target's shares "if the purchaser

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[120]15 U.S.C. § 78bb(a) (1982). This section provides that nothing the 1934 Act contains "shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder." *Id.*

[121]*CTS*, 107 S.Ct. at 1653 (Scalia, J., concurring).

[122]*Id.*

[123]*Id.* at 1653-56 (White, J., dissenting). Justices Blackmun and Stevens joined the dissent on the commerce clause issue.

[124]Edgar v. MITE Corp., 457 U.S. 624 (1982).

[125]*CTS*, 107 S.Ct. at 1654.

[126]*Id.*

[127]*Id.* at 1655.

crosses one of the Chapter's threshold ownership levels and a majority of . . . [the target's] shareholders refuse to give the purchaser voting rights''[128] because it is a restraint on interstate trade. Furthermore, he characterized a state law which permits a majority of a corporation's shareholders to prevent individual investors, including non-residents, from selling their shares to an out-of-state tender offeror and thereby frustrate any transfer of corporate control, as "the archetype of the kind of state law that the commerce clause forbids.''[129]

The dissenting Justices obviously were more concerned with the blocking of interstate transactions in securities than was the majority. They realized that the goal of the commerce clause was to prevent "economic Balkanization.''[130] There is no question but that the statute upheld in *CTS* presents such a risk, although it is not a foregone conclusion. It is highly unlikely that many corporations will flee Delaware, with its long corporate law history and a corporation statute that permits corporations to shield directors from liability,[131] to Indiana simply to get the protection of the Control Share Acquisition Chapter. Furthermore, few large publicly held corporations could do this because they are not "Indiana businesses." Some true "Indiana businesses" incorporated in Delaware have reincorporated in Indiana, and others might do the same, unless Delaware decides to adopt an antitakeover statute. What will likely happen is that more and more states will adopt antitakeover statutes. If they simply follow Indiana there will not be a problem, other than the problems that might result from the demise of the takeover game. However, if the statutes are tailored to meet the needs of a particular local corporation, and there is too much variance, the end result might be federal legislation clearly preempting the field of takeover regulation. Efforts to this effect already have started in Congress.[132]

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[128]*Id.*

[129]*Id.*.

[130]*Id.* at 1655, quoting from Hughes v. Oklahoma, 441 U.S. 322, 325-26 (1979).

[131]Del. Code Ann. tit. 8 § 102(b)(7) (Supp. 1986).

[132]*See* letter from Rep. Norman F. Lent (R. N.Y.), Wall St. J., Sept. 21, 1987, at 23, col. 1.

Of course amending the Williams Act to make takeover law uniform throughout the country, and to solve any real, or imagined problems with the current takeover scene will not satisfy all critics of hostile takeovers. *See* Grippo, MITE *Made Right: The Supreme Court Gives Illinois New Hope for a Takeover Law*, Ill. B.J. 844 (Nov. 1987).

Critics who go beyond opposing hostile takeovers simply to help the "hometown boys" might have a point. SEC Chairman Ruder has announced the SEC plans to examine the role takeover stocks played in the October 1987 stock market crash. The Wall St. J., Nov. 16, 1987, at 6, col. 1. In his speech Mr. Ruder reiterated the SEC position "that federal law should preempt state law in the area of tender offers . . . [and said that he believes] that corporations whose activities and ownership are national in scope shouldn't be given protection against takeovers by states where their primary production facilities are located." *Id.*

Only time will tell if this will happen, but it would be ironic indeed.

The reaction to *CTS* was predictable. Management generally applauded the decision[133] as did politicians.[134] Raiders did not,[135] nor did institutional investors,[136] many academics[137]and editorial writers.[138]

With the constitutionality of second generation antitakeover statutes established in *CTS*, an interesting question is just how far states will go beyond the Indiana scheme in efforts to protect local companies. This would create the "Balkanization" feared by the dissenting Justices. Many states will adopt statutes modeled on the Indiana act, which applies only to domestic corporations; however, some will be tempted to try to control takeovers of foreign corporations with significant local interests.[139] Such efforts seem to run afoul of *CTS* which emphasized the state of incorporation, but it is possible that under some circumstances "local interests" of a foreign corporation may give a state precedence over the state of incorporation.[140] Only time will tell if such efforts will pass muster.

Probably an even more interesting question will be the success of "work arounds" the Control Share Acquisition Chapter. It must be remembered that the *CTS* majority in effect embraced Williams Act supremacy clause preemption although it found it inapplicable in the particular case. This can be contrasted with *MITE* where the position was rebuffed by the Court. Only Justice Scalia's concurring opinion categorically rejected preemption short of "conflicting provisions" in state and federal regulatory schemes.[141] The Court at least implicitly recognized contingent tender offers, which are offers to accept shares on the condition the shares receive voting rights within a certain period

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[133]*See Takeover Artists Take a Direct Hit*, Bus. Wk., May 4, 1987, at 35.

[134]*See, e.g.*, Bayh, *The CTS Case*, 4 Indiana Securities Bulletin 1 (April 1987).

[135]*See Takeover Artists Take a Direct Hit*, Bus. Wk., May 4, 1987 at 35.

[136]Wall St. J., April 24, 1987, at 4, col. 2.

[137]*See* Romano, *State Takeover Laws: Constitutional but Dumb*, Wall St. J., May 14, 1987, at 22, col. 4.

[138]Wall St. J., April 23, 1987, at 26, col. 1. Following the decision in CTS even the Indianapolis Business Journal observed that "[a]s it stands now, the state of Indiana and the managers and employees of its public companies are winners. The large number of investors may, in fact, be losers." Indianapolis Bus. J., April 27-May 3, 1987, at 6, col. 1.

[139]*See* Comment, *Beyond* CTS: *A Limited Defense of State Tender Offer Disclosure Requirements*, 54 U. Chi. L. Rev. 657, 658 (1987).

[140]*See* Buxbaum, *supra* note 99, at 54. Professor Buxbaum posits that in the case of a Delaware corporation with all shareholders residing in California and none in Delaware a "Court faced with an absolute dilemma (e.g., inconsistent rules) may well give primacy to the shareholder state." *Id.*

[141]*CTS*, 107 S.Ct. at 1653 (Scalia, J., dissenting).

of time.[142] Thus a preemption problem might arise if states attempt to foreclose such contingent offers. Such efforts might be tempting if the contingent offer "work around" puts management on the spot; however, such provisions may tilt the playing field too much in management's favor even in the eyes of the *CTS* majority.

Corporate management of Indiana already have a decided advantage over offerors when it comes to voting on control share acquisition resolutions. At least management that has had the foresight to establish an employee benefit plan that owns shares of the corporation possess the advantage.

Common law[143] and statutes[144] generally prohibit voting of shares of a corporation owned, directly or indirectly, by a second corporation, either domestic or foreign, where the corporation owns, directly or indirectly, a majority of shares entitled to vote for directors of the second corporation. This restriction on circular ownership is designed to prevent management from perpetuating control by the corporation's direct or indirect ownership of its own shares. Such shares may be voted in "special circumstances"[145] which means where the purpose of the provision is not violated.[146]

There was some question at common law whether a corporation could vote its own shares held in a fiduciary capacity. Section 23-1-30-2(c) of the IBCL provides that the bar against circular voting does not limit the power of a corporation to vote shares "held by it in or for an employee benefit plan or in any other fiduciary capacity."[147] Voting shares held in an employee benefit plan on a control share acquisition resolution against an offeror could, and maybe should, be characterized as an effort by management to use a corporate investment to perpetuate itself in power. However, the definition of "interested shares" in the Control Share Acquisition Chapter is very specific. It refers to shares an officer or employee director of an issuing corporation "may exercise or direct the exercise of the voting power of the corporation in the election of directors."[148] The vote of shares held in an employee benefit plan would be a corporate act, and not the act of the officers or

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[142]*Id.* at 1647.

[143]*See* 1 G. Hornstein, Corporate Law and Practice § 311 (1959).

[144]*See, e.g.*, Ind. Code § 23-1-30-2(b) (Supp. 1987).

[145]*Id.*

[146]*See* 2 Model Bus. Corp. Act Ann. § 7.21 official comment § 3 (3d. ed. 1985).

[147]Ind. Code § 23-1-30-2(c) (Supp. 1987). The reference to "shares . . . held by it in or for an employee benefit plan" is not found in the comparable provision of the Revised Model Business Corporation Act, 2 Model Bus. Corp. Act Ann. § 7.21(c) (3d ed. 1985).

[148]Ind. Code §§ 23-1-42-3(2), (3) (Supp. 1987).

directors. Consequently, they probably can be voted against an offeror. Management will argue that they are voting the shares to protect the interests of the employees just as they argue that opposing hostile tender offers are to protect the interests of shareholders.

It is possible that management efforts to defeat takeover attempts by devices that reduce the value of corporate shares, such as poison pills, asset options, etc., may result in director liability for breach of duty to shareholders. This point was raised by the Court in *CTS*.[149] Some cases support this result,[150] but as states adopt or amend corporation statutes limiting or even eliminating director liability for breach of duty there is less likelihood that this will be a viable alternative.

As noted above,[151] a possible result of *CTS* will be the enactment of new federal legislation regulating takeovers that will clearly preempt the field. Congress may decide that the problems with takeovers are national rather than statewide. The debate then will be, and properly should be, over the real or imagined faults in the current system. The result might be legislation deferring to the states, where threatened targets may be able to influence state legislatures. Alternatively, it might be a complete acceptance of the "free market" approach at least as reflected in the Seventh Circuit's decision in *CTS*.[152] Or it may be somewhere in between. Again, only time will tell.

There are many questions that the *CTS* decision does not answer. For example, why are takeover attempts for corporations with less than 100 shareholders excluded from the typical state antitakeover statute? States should be as interested in protecting the shareholders of closely held or publicly held corporations with relatively few shareholders as they are in protecting the interests of shareholders of large publicly held corporations subject to Williams Act regulation. At least the latter have some market for their shares in case of mismanagement by those in control. There are many more small corporations than large with a greater likelihood that minority shareholders of closely held corporations will be frozen out by majority shareholders than there will be instances of shareholders of publicly held Indiana corporations being frozen out by a successful hostile offeror. These shareholders have little specific

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[149]*CTS* Corp. v. Dynamics Corp. of America, 107 S.Ct. at 1647, n.9. *See also* Buxbaum, *supra* note 99, at 57 n.88.

[150]*See* Hanson Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264 (2d Cir. 1986); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

[151]*See supra* note 132 and accompanying text.

[152]Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir. 1986). *See* Grundfest, *Proxmire's Doubletalk on Takeovers*, Wall St. J., Sept. 16, 1987 at 30, col. 3; Sprinkel, *The Real Issue in Corporate Takeovers*, Wall St. J., July 17, 1987, at 14, col. 3.

statutory protection under corporation acts like the IBCL. Also, why are there no limits on self-tenders by corporations that can be harmful to shareholders?

Even more interesting, at least to this author, is the role of corporate "constituencies" other than shareholders. The IBCL clearly permits directors to consider such constituencies in making corporate decisions.[153] This would include decisions opposing hostile tender offers. However, directors are not required to do so and there is nothing in Indiana law that limits an Indiana corporation from simply moving plants and production facilities from the state. A Maine statute requiring employers to provide a one-time severance pay to employees in event of a plant closing recently was upheld by the Supreme Court.[154] Perhaps Indiana political leaders and the General Assembly, which was willing to adopt legislation that directly or indirectly protects the jobs of top management of Indiana corporations, should consider such a statute to protect the rank and file employee if management decides to move jobs out of state. Such a statute probably would not be well received by most proponents of state antitakeover laws.[155]

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[153]*See* Grundfest, *Proxmire's Doubletalk on Takeovers*, Wall St. J., Sept. 16, 1987, at 30, col. 3; Sprinkel, *The Real Issue in Corporate Takeovers*, Wall St. J., July 17, 1987, at 14, col. 3.

[154]Fort Halifax Packing Co. v. Coyne, 107 S.Ct. 2211 (1987).

[155]There might be agreement on this point with opponents of state antitakeover statutes who favor the free market approach to corporate control.

A clearly unforeseen consequence of the Control Share Acquisition Chapter is that certain Indiana Corporations cannot sell their shares in California because it "negate[s] the democracy within the corporation by discriminating against a set of shareholders. Indianapolis Bus. J., December 21-27, 1987, at 3, col. 3.

Vertical Privity and Damages For Breach of Implied Warranty Under the U.C.C.: It's Time for Indiana to Abandon the Citadel

Harold Greenberg*

I. Introduction

A woman is injured when her daughter accidentally drops a container of drain cleaner, the container breaks, and its contents splash and burn the woman's legs, allegedly because the goods had not been adequately packaged by the manufacturer.[1] A couple purchases a mobile home from a dealer, only to discover after they move in that it is riddled with what are allegedly manufacturing defects and that the dealer has gone out of business.[2] A farmer purchases a planting machine from an authorized dealer of the machine's well-known manufacturer. The machine does not plant properly, allegedly because of manufacturing defects, and the farmer loses much of the season's crop.[3] In each of these implied warranty cases, the plaintiffs who suffered personal or economic injury, allegedly caused by goods which were unmerchantable when they left the hands of the manufacturer, were precluded from pursuing the manufacturer because of the absence of privity of contract between the respective plaintiffs and the particular manufacturer. Under present Indiana law, this result is required no matter how meritorious the claim may otherwise be.

It is the hypothesis of this article that in cases based on breach of implied warranty under the Uniform Commercial Code, the concept known as "vertical" privity, the absence of which prevents an injured buyer from recovering from a remote manufacturer or other remote seller, is an outmoded, artificial barrier which should, at long last, be abandoned.[4] Elimination of the vertical privity requirement does not mean automatic victory for each of these or any other plaintiffs, nor would it cause manufacturers to be insurers or prevent them from limiting

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[1]Lane v. Barringer, 407 N.E.2d 1173 (Ind. Ct. App. 1980).

[2]Candlelight Homes, Inc. v. Zornes, 414 N.E.2d 980 (Ind. Ct. App. 1981).

[3]Dutton v. International Harvester Co., 504 N.E.2d 313 (Ind. Ct. App.), *transfer denied* (1987).

[4]The obsolescence of requiring privity in warranty cases also calls for abandoning the similar concept of "horizontal" privity, but that action is not the main focus here. *See* the discussion of horizontal privity *infra* note 30 and accompanying text.

their exposure pursuant to the Uniform Commercial Code. It would, however, allow injured plaintiffs to present their cases, to prove that warranties were made and breached, and to recover any appropriate damages caused by that breach from the party directly responsible for and best able to prevent that breach: the manufacturer, while at the same time promoting judicial efficiency.

II. Privity: An Overview

A. The Meaning of Privity

The term, "privity of contract," is a legal term which has been much used, purportedly understood by everyone, but not often defined clearly, if at all. By 1931, the requirement of privity between a plaintiff and a defendant in an action based on an alleged breach of warranty had became so firmly entrenched in the law that it earned the description of being a "citadel."[5] This citadel of privity has since been described as being under assault,[6] having fallen,[7] in hasty retreat,[8] crippled,[9] decaying,[10] "razed in many states,"[11] "still standing,"[12] and possibly "only a historic relic in the year 2000."[13]

In Indiana, as elsewhere, some parts of the citadel have fallen completely.[14] With respect to actions for breach of implied warranty

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[5]Ultramares Corp. v. Touche, 255 N.Y. 170, 180, 174 N.E. 441, 445 (1931). Justice Cardozo is credited with coining this description in *Ultramares* (which involved the liability of accountants to non-clients with whom the accountants had not dealt but who had relied on financial documents negligently or fraudulently prepared by those accountants for clients). *See* H. Pratter & R. Townsend, Indiana Uniform Commercial Code with Comments 47 (1963); Prosser, *The Assault upon the Citadel (Strict Liability to the Consumer)*, 69 Yale L.J. 1099 (1960) [hereinafter *The Assault*].

[6]*Ultramares*, 255 N.Y. at 180, 174 N.E. at 445 ("The assault upon the citadel of privity is proceeding these days apace."); Prosser, *The Assault*, *supra* note 5.

[7]Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 Minn. L. Rev. 791 (1966) [hereinafter *The Fall*].

[8]J. White & J. Summers, Handbook of the Law under the Uniform Commercial Code § 11-7 (2d ed. 1980) [hereinafter White & Summers].

[9]Special Project, *Article Two Warranties in Commercial Transactions*, 64 Cornell L. Rev. 30, 255 (1978) [hereinafter Special Project].

[10]3 A. Squillante & J. Fonseca, Williston on Sales § 22-5, at 169 (4th ed. Supp. 1987) [hereinafter Williston on Sales].

[11]2 Am. L. Prod. Liab. 3d § 21:4 (1987).

[12]*Id.* § 21:5. *See* Edmeades, *The Citadel Stands: The Recovery of Economic Loss in American Products Liability*, 27 Case W. Res. L. Rev. 647 (1977).

[13]White & Summers, *supra* note 8.

[14]*See infra* notes 39-44 and accompanying text.

under Article 2 of the Uniform Commercial Code,[15] however, the citadel remains unaffected. Indiana courts continue to hold that a plaintiff cannot recover from a defendant for breach of implied warranty under Article 2 unless there is privity between them.[16]

What, then, is privity, how did it develop, and what does it require?

> Privity, in the law of contracts, is merely the name for a legal relation arising from right and obligation. . . . [It] is but a descriptive term, designating effect rather than cause. In short, privity of contract is legal relationship to the contract or its parties. To affirm one's right under a contract is therefore to affirm his privity with the party liable to him.[17]

Stated somewhat differently, "Privity of contract is the relation that exists between two contracting parties, and in cases of defective products this privity of contract is usually between buyer and seller."[18]

Privity of contract is a court-created requirement which relates back to a leading British case of the last century, *Winterbottom v. Wright.*[19]

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[15]The Uniform Commercial Code [hereinafter the Code or the U.C.C.] appears in the 1982 Indiana Code at sections 26-1-1-101 through 26-1-10-106. Article 2, Sales, appears in the 1982 Indiana Code at sections 26-1-2-101 through 26-1-2-725. Unless the Indiana text of the Code differs from the 1978 Official Text as promulgated by the Conference of Commissioners on Uniform State Laws and the American Law Institute, further citations to the Code will use the official, generic section citation form rather than the Indiana citation form. In the event there is difference between the two texts, the Indiana Code citation will be used to note the text applicable in Indiana.

[16]The most recent pronouncements are Dutton v. International Harvester Co., 504 N.E.2d 313 (Ind. Ct. App.), *transfer denied* (1987), and Prairie Prod., Inc., v. Agchem Div.-Pennwalt Corp., 514 N.E.2d 1299 (Ind. Ct. App.), *reh'g denied* (1987). In *Dutton*, the court of appeals affirmed summary judgment in favor of a manufacturer with whom the buyer of a planting machine did not have privity for purposes of enforcing the implied warranty of merchantability granted under U.C.C. § 2-314 (1978). In *Prairie Production*, which involved a breach of express warranty, the court reiterated the rule stated in *Dutton*. 514 N.E.2d at 1301. See the discussion of *Prairie Production infra* in the text accompanying notes 45-49 and 76-83.

[17]La Mourea v. Rhude, 209 Minn. 53, 57, 295 N.W. 304, 307 (1940); *see* BLACK'S LAW DICTIONARY 1362 (4th ed. 1951). Dean Murray has characterized this language as "the best judicial statement relating to privity." MURRAY ON CONTRACTS § 278, n.25 (2d rev. ed. 1974). The *La Mourea* court continued, "That simple truth removes the difficulty arising from the complicated notions expressed by judges and text writers concerning privity of contract." 209 Minn. at 57, 295 N.W. at 307. The case involved the technical absence of privity between a third party beneficiary and a promisor from whom the beneficiary sought to recover.

[18]2 AM. L. PROD. LIAB. 3D § 21:1 (1987).

[19]152 Eng. Rep. 402 (1842); *see also* Hiatt v. Brown, 422 N.E.2d 736, 739 (Ind. Ct. App. 1981); 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-318:01 (1984) [hereinafter 2 W. HAWKLAND]; Speidel, *Warranty Theory, Economic Loss and the Privity Requirement: Once More Into the Void*, 67 B.U.L. REV. 1, 24-25 n.54 (1987) [hereinafter *Warranty Theory*].

In that case, the defendant had contracted with the postmaster general to furnish and maintain mail coaches. Plaintiff, a mail-coach driver who was seriously injured when his coach overturned, brought a negligence action against the defendant based on defendant's failure to keep the coach in a fit and safe condition, as required by the contract. The court held that the coachman could not recover and declared:

> There is no privity of contract between these parties; and if the plaintiff can sue, every passenger, or even any person passing along the road, who was injured by the upsetting of the coach, might bring a similar action. Unless we confine the operation of such contracts as this to the parties who entered into them, the most absurd and outrageous consequences, to which I can see no limit would ensue.[20]

The real issue in the case was: to whom did the defendant owe the duty created by the contract? The response: only to the party with whom the defendant had contracted.[21] Thus, the citadel of privity was constructed as an almost impregnable defense in actions for breach of contractual duties brought by anyone other than the immediate parties to the contract which created those duties.

Privity became a part of warranty law in a society where the manufacturer and the seller with whom the buyer dealt were most often one and the same; there was no remote manufacturer in most cases.[22] Today,

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[20]152 Eng. Rep. at 405.

[21]*Id.*

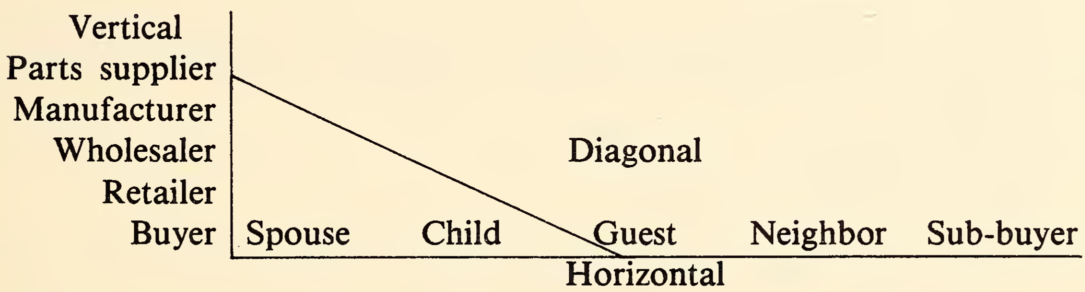
[22]*See* Freeman v. Navarre, 47 Wash. 2d 760, 765, 289 P.2d 1015, 1018 (1955); 2 L. Frumer & M. Friedman, Products Liability § 3.02[3], at 3-145 to 3-146 [hereinafter Frumer & Friedman]. As described in *Freeman*:

> In the eighteenth century, [as the law of warranty first developed] . . . goods and chattels were manufactured or made largely on a custom basis involving a personal, over-the-counter relationship between the customer, on the one hand, and the artisan, or mechanic, who made the goods or chattels, on the other. Mass production, large scale or national promotion and distribution were unknown. Actually, there was little need for a legal remedy for a consumer against a manufacturer in a distant city who had sold products to a distributor, who, in turn, had sold them to a jobber, who had sold to retailers, who had then sold to consumers. At that time, in practically all lawsuits in the fields of contracts and torts, the factor of personal relationship was quite apparent and loomed quite large in the consciousness of the law courts. The idea of a lawsuit by a consumer against a manufacturer, where no orthodox, over-the-counter, personal relationship existed, was unusual and seemingly quite difficult for the courts to contemplate. There is some similarity, perhaps, between the philosophy or logic of the privity of contract doctrine and that inherent in the remnants of the concept of *caveat emptor*, the latter, certainly, inherited from a time when business morality was, perhaps, somewhat different from that prevailing today.

47 Wash. 2d at 765, 289 P.2d at 1018.

we speak of a chain of distribution in which "[t]he middleman is no more than a conduit, a mere mechanical device, through which the thing is to reach the ultimate user."[23]

In the context of a warranty of the quality or performance of goods, the relationship between the parties for purposes of a discussion of privity is best viewed as the sides of a right angle, as illustrated in the figure which follows. "Vertical" privity describes the chain of distribution, from the supplier of any component parts, through the manufacturer of the finished goods, the wholesale and retail dealers, and ultimately to the retail buyer of those goods. "Horizontal" privity describes the persons to whom any warranty extends beyond the retail buyer, such as members of the buyer's family, guests, neighbors, subpurchasers, etc., who may be affected by a breach of the warranty.[24] It has also been suggested that there is a third type of privity, "diagonal" privity, which completes a right triangle, and describes the relationship between a party in the chain of distribution and a party in the horizontal line.[25]



If a court requires privity between a plaintiff and a defendant, vertical privity describes the person in the chain of distribution who is a proper defendant in a suit by the particular plaintiff, *i.e.*, who is responsible on the warranty which allegedly has been breached. Similarly, horizontal privity describes who along the horizontal line from the retail buyer of the goods to the person affected by the breach of warranty is a proper plaintiff, *i.e.*, who is a beneficiary of the warranty, or to whom does

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[23]Prosser, *The Fall*, *supra* note 7, at 799; *accord* Santor v. A & M Karagheusian, Inc., 44 N.J. 52, 60, 207 A.2d 305, 309 (1965); Kassab v. Central Soya, 432 Pa. 217, 226, 246 A.2d 848, 853 (1968).

[24]*See, e.g.*, Am. L. Prod. Liab. 3d § 21:4 (1987); 2 W. Hawkland, *supra* note 19, § 2-318:01; White & Summers, *supra* note 8, § 11-2; Williston on Sales, *supra* note 10, § 22-5.

[25]Ezer, *The Impact of the Uniform Commercial Code on the California Law of Sales Warranties*, 8 U.C.L.A. L. Rev. 281, 324-26 (1961) (in which the term originated); *see* 2 W. Hawkland, *supra* note 19, § 2-318:01, n.4.

the warranty extend.[26] Diagonal privity links the two lines and describes who at each end of the diagonal line is a proper plaintiff and is a proper defendant in a particular situation.[27]

B. Privity and the U.C.C.

The Uniform Commercial Code deals with privity only in section 2-318. When Indiana enacted the Code in 1963,[28] that section provided:

> A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.[29]

This language is a limited legislative attack directed only to the wall of horizontal privity and has reached only its lower levels.[30] With respect

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[26]*See, e.g.*, Williams v. West Penn Power Co., 502 Pa. 557, 467 A.2d 811 (1983); H. Greenberg, Rights and Remedies under U.C.C. Article 2 § 14.30 (1987) [hereinafter H. Greenberg].

[27]*See* Ezer, *supra* note 25, at 324-26.

[28]1963 Ind. Acts 317.

[29]Ind. Code § 26-1-2-318 (1982).

In 1966, because there continued to be a lack of uniformity among the states with respect to the privity requirement, the Permanent Editorial Board of the Code designated the language quoted above as Alternative A to § 2-318 and approved two additional alternatives as choices for states adopting the Code. *See* Permanent Editorial Board Note in 1966 Amendment to § 2-318; 2 W. Hawkland, *supra* note 19, § 2-318, at 407; Comment, *Enforcing the Rights of Remote Sellers under the UCC: Warranty Disclaimers, The Implied Warranty of Fitness for a Particular Purpose and the Notice Requirement in the Nonprivity Context*, 47 U. Pitt. L. Rev. 873, 884-85 (1986) [hereinafter *Rights of Remote Sellers*].

Alternative B provides:

> A seller's warranty whether express or implied extends to any natural person who may reasonably be expected to use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

U.C.C. § 2-318.

Alternative C provides:

> A seller's warranty whether express or implied extends to any person who may be reasonably expected to use, consume or be affected by the goods and who is injured by breach of the warranty. A seller may not exclude or limit the operation of this section with respect to injury to the person of an individual to whom the warranty extends.

Id.

[30]*See* H. Pratter & R. Townsend, *supra* note 5, at 47. Whether it restricts further judicial assault on that wall, e.g., by extending warranty protection to employees, passers-

to vertical privity, the drafters themselves said that this provision "is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain."[31] The attack on or defense of the tower of vertical privity remains the assignment of the courts for further development in the common law tradition.[32]

III. Privity: Indiana's Approach

A. *The Assault on Privity in Indiana*

In Indiana, as elsewhere, the doctrine of privity traces back to *Winterbottom v. Wright*.[33] In the ensuing years, cracks began to appear in the privity barrier, and two leading cases caused the national collapse of major sections of the citadel of privity: *MacPherson v. Buick Motor Co.*[34] and *Henningsen v. Bloomfield Motors, Inc.*[35] *MacPherson* abolished the need for vertical privity in negligence actions by a buyer against a manufacturer if the goods involved (there, an automobile), if negligently made, are inherently dangerous and cause personal injury.[36] In *Henningsen*, the court imposed strict liability in tort, without regard to negligence and despite the absence of vertical or horizontal privity, upon both the manufacturer and the seller of a product (again, an automobile)

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by, bailees, or subsequent buyers from the first retail buyer, remains a matter for further development in many other jurisdictions, but not presently in Indiana where the provision is interpreted restrictively. *Compare* Davidson v. John Deere & Co., 644 F. Supp. 707 (S.D. Ind. 1986); Lane v. Barringer, 407 N.E.2d 1173, 1176 (Ind. Ct. App. 1980) (Ratliff, J., concurring in part, dissenting in part) *with* Morrow v. New Moon Homes, Inc., 548 P.2d 279 (Alaska 1976); Milbank Mut. Ins. Co. v. Proksch, 309 Minn. 106, 244 N.W.2d 105 (1976); Salvador v. Atlantic Steel Boiler Co., 457 Pa. 24, 319 A.2d 903 (1974); JKT Co. v. Hardwick, 274 S.C. 413, 265 S.E.2d 510 (1980). Some other jurisdictions also read § 2-318 restrictively. *See, e.g.*, Bailey v. ITT Grinnell Corp., 536 F. Supp. 84 (N.D. Ohio 1982); Miller v. Sears, Roebuck & Co., 148 Ill. App. 3d 1022, 500 N.E.2d 557 (1986) (no expansion in either case).

[31]U.C.C. § 2-318, Official Comment 3.

[32]*See, e.g.*, H. Pratter & R. Townsend, *supra* note 5, at 47; White & Summers, *supra* note 8, § 11-3 at 403; Murray, *Products Liability v. Warranty Claims: Untangling the Web*, 3 J.L. & Com. 269, 275-78 (1983).

[33]152 Eng. Rep. 402 (1842); *see* Hiatt v. Brown, 422 N.E.2d 736, 739 (Ind. Ct. App. 1981). See the discussion of *Winterbottom* in the text accompanying notes 19-21, *supra*.

[34]217 N.Y. 382, 111 N.E. 1050 (1916).

[35]32 N.J. 358, 161 A.2d 69 (1960).

[36]*See* Prosser, *The Assault*, *supra* note 5, at 1100.

which, because of an apparent defect, caused serious personal injury.[37] During the four decades between the two cases, in something of a precursor to *Henningsen*, more courts nationally and in Indiana began to impose a similar form of strict liability on the manufacturers of foods or bottled goods sold for human consumption without requiring vertical or horizontal privity.[38]

Indiana followed the lead of these two landmark cases. When the first opportunity arose, the Indiana Supreme Court expressly applied the *MacPherson* rule and affirmed the recovery of damages from the negligent manufacturer of a defective farm combine by an injured farmer who had purchased the combine from another farmer and was not in either vertical or horizontal privity with the manufacturer.[39] The court thereby abolished the requirement of either vertical or horizontal privity in negligence cases involving inherently dangerous products with latent defects. In doing so, the court stated:

> As so often happens in the development of the common law, eventually the exception becomes the rule, and that is what has happened during the last sixty years to the principle under consideration here. . . .
>
> As stated by the leading authorities, public policy has compelled this gradual change in the common law because of the industrial age where there is no longer the usual privity of contract between the user and the maker of a manufactured machine. On the other hand, there must be reasonable freedom and protection for the manufacturer. He is not an insurer against accident and is not obligated to produce only accident-proof machines. The emphasis is on the duty to avoid hidden defects or concealed dangers. . . .[40]

Six years later, Indiana followed the lead of *Henningsen* when it expressly adopted the principle of strict products liability, without requiring proof of negligence or privity, as enunciated in the Restatement

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[37] *See* Prosser, *The Fall*, *supra* note 7, at 791-97. The injured party in *Henningsen* was the wife of the buyer of an automobile, thus raising the question of whether the warranty from the dealer to the husband-buyer extended horizontally to his wife. The issue of vertical privity was raised by the naming of the manufacturer of the automobile as a defendant.

[38] *See* Coca Cola Bottling Works v. Williams, 111 Ind. App. 402, 413, 37 N.E.2d 702, 706 (1941); Prosser, *The Fall*, *supra* note 7, at 794-798.

[39] J.I. Case Co. v. Sandefur, 245 Ind. 213, 197 N.E.2d 519 (1964); *see* Elliott v. General Motors Corp., 296 F.2d 125 (7th Cir. 1961), *cert. denied*, 369 U.S. 860 (1961) (in which the federal court had earlier concluded that the *MacPherson* rule did apply in Indiana).

[40] *J.I. Case Co.*, 245 Ind. at 221-22, 197 N.E.2d at 522-23.

(Second) of Torts, § 402A,[41] which itself solidified the *Henningsen* rule.[42] The Indiana Legislature took a further step in this regard when it enacted the state's first Product Liability Act.[43]

Despite the continuing assault on and collapse of the citadel elsewhere,[44] the assault in Indiana has proceeded extremely slowly, and a major part of the structure remains unscarred. Until *Prairie Production, Inc. v. Agchem Div.-Pennwalt Corp.*,[45] the Indiana courts had not been confronted squarely with the privity issue in cases based on breach of an express warranty.[46] In this case, the defendant-manufacturer allegedly had made an express warranty that its product would control corn earworms, but there was no privity between the plaintiff-farmer and the defendant because the plaintiff had purchased the product as part of a crop-spraying service. Plaintiff lost part of its crop due to earworm infestation. The court of appeals relied on the leading case of *Randy Knitwear, Inc. v. American Cyanamid Co.*,[47] observing that "the authority in favor of discarding the privity requirement in express warranty cases is overwhelming."[48] In doing so, the court reversed summary judgment in favor of the defendant, and ruled that if the representations of the defendant-manufacturer amount to an express warranty, a question of fact, the buyer may recover economic losses for breach despite the absence of privity. However, the court restated the Indiana rule that in the absence of privity, a buyer cannot recover economic damages from a remote manufacturer if the claim is based on breach of implied warranties.[49]

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[41]*See* Cornette v. Searjeant Metal Prods., Inc., 147 Ind. App. 46, 258 N.E.2d 652 (1970).

[42]*See* Prosser, *The Fall*, *supra* note 7. Dean Prosser is the author of § 402A. *See* Edmeades, *supra* note 12, at 650, 663; Murray, *supra* note 32, at 275. But the concept of strict products liability was apparently first espoused some 20 years earlier by Karl Llewellyn, the principal drafter of the U.C.C., in a provision which was not included in the final official text. *See* Murray, *supra* note 32, at 275.

[43]1978 Ind. Acts, Pub. L. 141, § 28.

[44]*See, e.g.*, Morrow v. New Moon Homes, Inc., 548 P.2d 279 (Alaska 1976); Groppel Co. v. United States Gypsum Co., 616 S.W.2d 49 (Mo. Ct. App. 1981); Spring Motors Distrib., Inc. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660 (1985); Kassab v. Central Soya, 432 Pa. 217, 246 A.2d 848 (1968); Comment, *Rights of Remote Sellers*, *supra* note 29, at 881.

[45]514 N.E.2d 1299 (Ind. Ct. App.), *reh'g denied* (1987).

[46]*See id.* at 1301. Language in earlier cases suggested that lack of privity would not be a defense in express warranty cases. *See* Candlelight Homes, Inc. v. Zornes, 414 N.E.2d 980 (Ind. Ct. App. 1981); Richards v. Goerg Boat & Motors, Inc., 179 Ind. App. 102, 384 N.E.2d 1084, *transfer denied* (1979); Bepko, *Commercial Law, Survey of Recent Developments in Indiana Law*, 15 Ind. L. Rev. 109, 118 (1982).

[47]11 N.Y.2d 5, 181 N.E.2d 399 (1962).

[48]514 N.E.2d at 1302.

[49]*Id.* at 1301, citing *Richards, Candlelight Homes, Dutton*, and Ridge Co., Inc. v. NCR Corp., 597 F. Supp. 1239 (N.D. Ind. 1984).

Thus, in implied warranty cases under the U.C.C., the absence of privity is a barrier behind which the defendant is totally protected regardless of the cause or nature of the damage or the justice of the plaintiff's claim. The two cases which furnish the strongest support for the barrier are *Lane v. Barringer*[50] and *Candlelight Homes, Inc. v. Zornes.*[51]

Lane, which involved the woman whose legs were splashed with caustic drain cleaner when the container broke,[52] contained issues of both vertical and horizontal privity, although the thrust of the court's opinion addressed only the vertical. Plaintiff named as defendants in her suit for breach of the implied warranty of merchantability[53] the entire vertical chain of distribution: the supplier of the container, the manufacturer of the drain cleaner, the distributor, the supermarket where the injury occurred, and the market operators. In affirming summary judgment in favor of all remaining defendants,[54] two members of the court held that the absence of privity between the plaintiff and the remaining defendants was an insurmountable barrier to her claim against them:

> Clearly, privity of contract is no longer required if a personal injury action for a defective product sounds in tort; either on a negligence theory or on the theory of strict liability in tort. . . . However, the abrogation of the privity requirement in tort law has not eliminated the privity requirement when the cause of action sounds in contract for breach of warranty.[55]

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[50]407 N.E.2d 1173 (Ind. Ct. App. 1980).

[51]414 N.E.2d 980 (Ind. Ct. App. 1981).

[52]*See* discussion in the opening paragraph of this article *supra* note 1.

[53]U.C.C. § 2-314(2)(c) and (e) require that for goods to be merchantable, they must, *inter alia*, be fit for their ordinary purposes and be adequately packaged or contained. The container slipped out of the hands of the plaintiff's married daughter as she took it from a supermarket shelf to put in her shopping cart. The court assumed, for the purposes of argument, that there had been a sale. For reasons unknown, the plaintiff had allowed the statute of limitations for actions in negligence or strict liability—two years—to pass, and those actions were barred. Her only possible claim was for breach of warranty under the Code, the limitation on which is four years from the accrual of the cause of action pursuant to U.C.C. § 2-725.

[54]The market operators were dismissed by stipulation; the market itself, a corporation, was never properly served with process and, although named, was never a party. 407 N.E.2d at 1175.

[55]*Id.* A later, federal case characterized this distinction as "archaic" and declared that adoption of the U.C.C. had displaced common law actions for breach of implied warranty. Corbin v. Coleco Indus., Inc., 748 F.2d 411 (7th Cir. 1984). The court held that because the buyer of an above-ground swimming pool from his neighbor was not in privity with the manufacturer, as required by Indiana law if the suit is for breach of

The third judge would have abolished the vertical privity requirement in all cases involving personal injury but agreed with the result because he found no horizontal privity under section 2-318 of the Code.[56]

In *Candlelight Homes*, the plaintiff-buyers who had purchased a defective mobile home from an authorized dealer of the defendant-manufacturer brought an action for breach of implied warranty against both the dealer and the manufacturer, but the dealer had gone out of business. The court reversed a judgment for the plaintiffs against the manufacturer and held that in a "suit for breach of implied warranty for loss of bargain, privity must be shown, or facts must be present" to prove an exception such as the seller's agency with the manufacturer or the manufacturer's participation in the sale.[57] Neither had been shown. Although these "exceptions," established in two earlier cases,[58] do not establish true privity in the sense that the manufacturer is a party to the sales contract with the buyer, they do establish a direct relationship between the manufacturer and the buyer.[59]

Lane and *Candlelight Homes* have been relied on repeatedly in subsequent cases to bar recovery by non-privity plaintiffs without regard to whether vertical or horizontal privity was at issue.[60] The most recent

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an implied warranty connected with the sale of goods, the manufacturer was entitled to summary judgment in its favor. 748 F.2d at 416.

In Thiele v. Faygo Beverage, Inc., 489 N.E.2d 562 (Ind. Ct. App.), *transfer denied* (1986), the court concluded that actions for breach of warranty in tort and for strict products liability, first introduced by approval of RESTATEMENT (SECOND) OF TORTS, § 402A, and subsequently codified in the Indiana Product Liability Act, IND. CODE §§ 33-1-1.5-1 to -8 (1982), are indistinguishable. A complaint which states a count for strict products liability and for breach of warranty in tort will be considered duplicitous. *Thiele*, 489 N.E.2d at 584. *See* Whittaker v. Federal Cartridge Corp., 466 N.E.2d 480, 481 n.2 (Ind. Ct. App. 1984).

[56]407 N.E.2d at 1177-78 (Ratliff, J., concurring in part, dissenting in part). *See supra* notes 28-32 and accompanying text.

[57]414 N.E.2d 980, 982 (Ind. Ct. App. 1981). The court stated that the amended complaint alleged breach of the implied warranty of fitness for particular purpose. As discussed *infra* in the text accompanying notes 161-172, such a warranty rarely, if ever, exists without privity or a direct relationship between the maker of the warranty and the beneficiary thereof. The case could have been decided against the plaintiffs on the basis that they failed to prove that such a warranty had been made by the manufacturer. Instead, the court treated the case as involving "breach of implied warranty," which should be taken to mean breach of the implied warranty of merchantability.

[58]Richards v. Goerg Boat & Motors, Inc., 179 Ind. App. 102, 384 N.E.2d 1084, *transfer denied* (1979) (participation in the sale); Thompson Farms, Inc. v. Corno Feed Prods., 173 Ind. App. 682, 366 N.E.2d 3 (1977) (agency).

[59]*See Richards*, 179 Ind. App. at 112, 384 N.E.2d at 1092.

[60]*See, e.g.*, Corbin v. Coleco Indus., Inc., 748 F.2d 411, 414 (7th Cir. 1984) (suit by sub-buyer against remote manufacturer); Davidson v. John Deere & Co., 644 F. Supp. 707, 713 (N.D. Ind. 1986) (suit by employee against manufacturer who sold directly to

of these, *Dutton v. International Harvester Co.*,[61] cited *Lane* and stated, "An essential element for the recovery of incidental and consequential damages due to breach of warranty is privity of contract."[62] Quoting from an earlier case, the court declared that "[t]he rule in Indiana is[,] '[i]mplied warranties of merchantability and fitness for particular use, as they relate to economic loss from the bargain, cannot ordinarily be sustained between the buyer and a remote manufacturer.'"[63] Accordingly, the *Dutton* court affirmed summary judgment in favor of the manufacturer of a defective planting machine and against the farmer-buyer who had purchased the machine from an authorized distributor, claimed breach of implied warranty, and sought damages for his economic loss (there were no personal injuries).[64]

The rumblings of a further Indiana assault on the citadel had earlier been heard in *Barnes v. MacBrown & Co.*,[65] which involved a warranty parallel to those of the Code, the implied warranty of habitability. The Indiana Supreme Court held that the second purchaser of a dwelling, who had never dealt with the builder and was not in privity with him, could recover for breach of the warranty even though the claim involved only the economic loss of the cost of repairing a waterproof basement, not personal injury. In doing so, the court quoted from *J.I. Case Co. v. Sandefur*,[66] and stated:

> The logic which compelled this change in the law of personal property is equally persuasive in the area of real property. Our society is an increasingly mobile one. Our technology is increasingly complex. The traditional requirement of privity between builder-vendor and a purchaser is an outmoded one.[67]

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employer); Ridge Co. v. NCR Corp., 597 F. Supp. 1239, 1242 (N.D. Ind. 1984) (suit by buyer against component part supplier); Gonzales v. Kil Nam Chun, 465 N.E.2d 727, 731 (Ind. Ct. App. 1984) (suit by employee of borrower of scaffolding against owner).

[61]504 N.E.2d 313 (Ind. Ct. App.), *transfer denied* (1987).

[62]*Id.* at 316.

[63]*Id.* (quoting Richards v. Goerg Boat & Motors, Inc., 179 Ind. App. 102, 112, 384 N.E.2d 1084, 1092, *transfer denied* (1979)). The error in this statement with respect to the implied warranty of fitness for particular purpose under U.C.C. § 2-315 is discussed *infra* in the text accompanying notes 161-172.

[64]504 N.E.2d at 319. The statement of the court that after repair attempts by the seller, the manufacturer "extended its warranty for an additional year," indicates that the case also involved an express warranty. *Id.* at 315. However, the buyer-appellant apparently did not raise the issue of express warranty in his appeal. Had he done so, he might have avoided the privity issue. *See infra* text accompanying notes 45-49.

[65]264 Ind. 227, 342 N.E.2d 619 (1976).

[66]245 Ind. 213, 197 N.E.2d 519 (1964); *see supra* text accompanying notes 39-40.

[67]*Barnes*, 264 Ind. at 229, 342 N.E.2d at 620.

Although cited with approval in later cases involving real property,[68] subsequent cases involving sales of goods have failed to take up this lead either by ignoring the reasoning of *Barnes* altogether or by attempting to distinguish it despite the clearly stated position of the court that privity had already been eliminated as a requirement in cases involving the law of personal property.[69]

The current status of privity in Indiana, therefore, is that it remains a barrier against any lawsuit brought for breach of implied warranty under the U.C.C.

B. *The Battle Plan for the New Assault in Indiana*

For the reasons developed in the remainder of this article, the assault on vertical privity in Indiana should resume until the citadel is demolished. There are two reasons why the assault should resume. First, permitting the damaged buyer to proceed against the manufacturer will impose liability for defective goods on the party most able to prevent the defect and to bear its cost, and who should, and probably will, ultimately bear the liability in any event. Second, permitting a direct suit against the manufacturer will result in judicial efficiency and will avoid substantial unfairness to the buyer and other parties in the chain of distribution between the buyer and the manufacturer. Because of the substantial protections available under the U.C.C., allowing suit against a remote manufacturer for breach of implied warranty will neither make him an insurer nor will it impose upon him any liability beyond his reasonable expectations.

In order to review the battle plan in a logical fashion, the points of the attack should be examined. Privity's greatest strength in Indiana is as a defense against claims of breach of the implied warranty of merchantability. That strength lessens significantly when the defense is raised against the Code's other implied warranty, fitness for a particular purpose. Because these warranties differ in their creation and characteristics, they must be dealt with separately. We attack first at the citadel's strongest point.

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[68]*See, e.g.*, Zimmerman v. Moore, 441 N.E.2d 690, 694 (Ind. Ct. App. 1982); Wagner Constr. Co. v. Noonan, 403 N.E.2d 1144, 1148 (Ind. Ct. App. 1980).

[69]*See, e.g.*, Corbin v. Coleco Indus., Inc., 748 F.2d 411, 415 (7th Cir. 1984) (comment that *Barnes* is no authority for a U.C.C. case); Ridge Co. v. NCR Corp., 597 F. Supp. 1239, 1243 (N.D. Ind. 1984) (no evidence in *Barnes* that the court intended to go beyond habitability). In stating that Indiana law requires privity in a warranty action based on contract, the court in Neofes v. Robertshaw Controls Co., 409 F. Supp. 1376 (S.D. Ind. 1976), incorrectly forecast the possible future effect of *Barnes* on the privity requirement with a citation, "but cf." 409 F. Supp. 1379.

1. The Implied Warranty of Merchantability.—The U.C.C. states, "Unless excluded or modified (section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind."[70] The basic definition of "merchantability" requires that the goods be "fit for the ordinary purposes for which such goods are used."[71] Without some action by the seller to exclude or modify,[72] this warranty arises automatically in every sale in the chain of distribution.[73] The Code simply does not state to whom in the chain the warranty extends, nor does it limit the benefits of the warranty to the seller's immediate buyer in the chain.[74] However, without some direct contact between the manufacturer and the retail buyer, there is neither traditional privity of contract nor an exception to it. Nevertheless, both the policy on which this warranty is based and modern business circumstances and practices support the conclusion that either (1) there really is a form of privity between the remote manufacturer and the buyer, although not direct or face to face,[75] or (2) the tower of vertical privity should be abandoned and demolished.

The nature of the implied warranty is that it arises automatically in every sale by a merchant unless it is specifically limited or disclaimed; it is an obligation imposed on the seller as a matter of law. Thus, it involves two basic situations: sales in which the seller also gives an express warranty and sales in which there is no express warranty whatever.

In sales involving an express warranty, in which privity is no longer a barrier to a buyer's action against a remote manufacturer for breach of that warranty,[76] there is no reason for the barrier to stand against a similar suit for breach of the implied warranty of merchantability. In *Prairie Production, Inc. v. Agchem Div.-Pennwalt Corp.,*[77] the recent case which abolished the privity requirement with respect to express warranties only, the court first cited, described and relied on the two Indiana cases in which the barrier of privity was broken in implied warranty cases because of the manufacturer's contacts with the buyer:

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[70]U.C.C. § 2-314(1).

[71]U.C.C. § 2-314(2)(c).

[72]*See* discussion of disclaimers of warranty and limitation of remedy under §§ 2-316 and 2-719 *infra* notes 176-181 and accompanying text.

[73]*See* U.C.C. § 2-314, Official Comment 2.

[74]*See* Speidel, *Warranty Theory, supra* note 19, at 42-43.

[75]Prof. Speidel suggests that, based on a relational perspective of contract law, there is indeed a connection between the remote manufacturer and the buyer which justifies the ability of the buyer to recover from the manufacturer. *See* Speidel, *Warranty Theory, supra* note 19.

[76]*See* Prairie Prod., Inc. v. Agchem Div.-Pennwalt Corp., 514 N.E.2d 1299 (Ind. Ct. App.), *reh'g denied* (1987).

[77]*Id.*

Richards v. Goerg Boat & Motors, Inc.,[78] and *Thompson Farms, Inc. v. Corno Feed Products*.[79]

In *Richards*, the buyer had talked with the manufacturer's personnel at a boat show, had attended a demonstration at the manufacturer's plant, and, when problems arose after the sale, dealt directly with the manufacturer concerning problems with the boat. However, the buyer made his purchase from the intermediate dealer. In *Thompson Farms*, the court found that a special agency relationship existed between the dealer and the manufacturer involving arrangements for financing, and that the manufacturer had solicited the buyer directly as a customer for the hog houses involved and had inspected them after construction for conformity to blueprints.[80] In *Prairie Production*, however, the court found that there was no direct participation in the sale by the manufacturer who gave an express warranty.

By distinguishing *Richards* and *Thompson Farms* in this way, the court seems to be asserting that unless the contact between the manufacturer and the buyer is oral and face to face, the contact is insufficient to break through the barrier of privity; that advertising literature, no matter how descriptive or laudatory, does not even crack the barrier if it does not rise to the level of an express warranty. In describing *Randy Knitwear, Inc. v. American Cyanamid Co.*,[81] which the Indiana court found to exemplify the overwhelming weight of authority and virtually indistinguishable from the case before it,[82] the court of appeals stated:

> It justified discarding the privity requirement under the circumstances of that case by observing that manufacturers commonly extoll the merits and quality of their products in newspapers, periodicals and other media directed to each purchaser in the chain of distribution. These affirmations, *which may or may not constitute an express warranty*, may effectively induce the purchase, and are even intended to have that effect.[83]

What, then, of the case in which the manufacturer engages in an extensive advertising campaign to induce sales but carefully avoids making any express warranties? Surely, the written contact through *Time* magazine or *The Wall Street Journal* is as effective as ten or fifteen minutes at a trade show to establish a form of direct contact between the manufacturer and the buyer to satisfy the privity requirement.

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[78] 179 Ind. App. 102, 384 N.E.2d 1084, *transfer denied* (1979).

[79] 173 Ind. App. 682, 366 N.E.2d 3 (1977).

[80] *See Prairie Prod.*, 514 N.E.2d at 1301.

[81] 11 N.Y.2d 5, 226 N.Y.S.2d 363, 181 N.E.2d 399 (1962).

[82] *Prairie Prod.*, 514 N.E.2d at 1302.

[83] *Id.* at 1302-03 (emphasis added).

Moreover, the making of the express warranty itself should be sufficient to establish the required contact. The nature and quality of the express warranty itself may be the inducement, as in the automotive industry where the manufacturers are presently giving warranties of different coverages and durations. And in the *Richards* case, the court declared: "An express warranty is a contract between the buyer and the seller. . . ."[84] This being so, if a sale includes a manufacturer's express warranty, the existence of a contract between the manufacturer and the buyer establishes privity between them. This should be sufficient to support an action against the manufacturer for breach of the express warranty or the implied warranty of merchantability or both,[85] unless the manufacturer has taken affirmative steps to modify or disclaim warranties.[86] Furthermore, the privity requirement should be abolished in all cases involving the implied warranty of merchantability, whether or not the remote manufacturer has given an express warranty.

The concept of implied warranty is not and never has been purely contractual, but is in reality a blend of the principles underlying both contracts and torts.[87] As described by the court of appeals, in Indiana implied warranties "arise out of the *status relationship* between a buyer making a purchase from a seller; that is, they arise because the seller happens to be a merchant *or* has knowledge about the buyer's purpose and reliance."[88] A basic difference between warranty and negligence is

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[84]179 Ind. App. at 118, 384 N.E.2d at 1095.

[85]*See* Szajna v. General Motors Corp., 115 Ill.2d 294, 503 N.E.2d 760, *reh'g denied* (1986), in which the court stated that if the manufacturer gives a written warranty pursuant to the Magnuson-Moss Federal Warranty Act (15 U.S.C. §§ 2301-2310 (1976)), as most manufacturers will, the manufacturer "establishes privity between the warrantor [manufacturer] and the consumer which, though limited in nature, is sufficient to support an implied warranty under sections 2-314 and 2-315 of the UCC." *Id.* at 305, 503 N.E.2d at 769. The Illinois Supreme Court therefore reversed the holding of the intermediate appellate court that although there was privity for purposes of the express warranty, there was no privity for purposes of the implied warranty of merchantability.

But see Walsh v. Ford Motor Co., 588 F. Supp. 1513 (D.D.C. 1984). In *Walsh*, the court ruled that although an action under the Magnuson-Moss Act may include a claim for breach of implied warranties which arise under the U.C.C., the issue of privity is governed by state law without reference to the Magnuson-Moss Act. *Id.* at 1526-1527.

[86]*See infra* text accompanying notes 176-181.

[87]*See, e.g.*, Frumer & Friedman, *supra* note 22, § 3.02[3], at 3-143 to 3-144; Prosser, *The Assault*, *supra* note 5, at 1126-34; Rabin & Grossman, *Defective Products or Realty Causing Economic Loss: Toward a Unified Theory of Recovery*, 12 Sw. U.L. Rev. 4, 49-50 (1981) [hereinafter Rabin & Grossman]. Dean Prosser called warranty "a freak hybrid born of the illicit intercourse of tort and contract." *The Assault*, *supra* note 5, at 1126.

[88]Richards v. Goerg Boat & Motors, Inc., 179 Ind. App. 102, 110, 384 N.E.2d 1084, 1091, *transfer denied* (1979) (emphasis added). *See* discussion of Speidel, *Warranty Theory*, *supra* note 75.

that warranty is not based on fault but focuses on the condition of the product by imposing a form of strict liability on the seller.[89]

One major purpose of warranty law was to change the rule from *caveat emptor* to a rule which gives the buyer what he had reason to expect: goods fit for their ordinary uses.[90] In his article on the fall of the citadel, prompted by the explosion caused by *Henningsen v. Bloomfield Motors*,[91] Dean Prosser reflected that had another decade passed before a decision like *Henningsen* was announced, the law of warranties might itself have been changed to eliminate privity as a defense between remote manufacturers and injured consumers.[92] Since *Henningsen*, that change has occurred in most jurisdictions, at least with respect to personal injury and property damage,[93] but not in Indiana.

The Indiana courts speak of privity being required to protect the bargained for expectations of the parties.[94] This position is based on the false premise that the parties must deal with each other face to face in order to know those expectations, a premise which harks back to the 19th Century business climate and philosophy expressed in *Winterbottom*

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[89]*See* Gregory v. White Truck & Equip. Co., 163 Ind. App. 240, 255-56, 323 N.E.2d 280, 289 (1975); Frumer & Friedman, *supra* note 22, § 3.01[1], at 3-5; Prosser, *The Assault*, *supra* note 5, at 1126-34.

[90]*See* Prosser, *The Assault*, *supra* note 5, at 1145. It has been suggested that had Restatement (Second) of Torts, § 402A, been approved by the American Law Institute at the time Karl Llewellyn was chief reporter for the Code and the chief drafter of Article 2, he would not have included any provisions on warranty at all. Murray, *supra* note 32, at 276. This suggestion may go a bit too far. As strict liability in tort has developed, the general rule has been that recovery can only be for personal injury and property damage but not for economic loss. *See, e.g.*, Sanco v. Ford Motor Co., 771 F.2d 1081 (7th Cir. 1985); Spring Motors Distribs., Inc. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660 (1985); Prosser, *The Assault*, *supra* note 5, at 1120-23 (whose position in this regard is discussed *infra* in note 131). This, too, may change, but the change will likely be long in coming.

[91]32 N.J. 358, 161 A.2d 69 (1960); *see supra* discussion in text accompanying notes 35-37.

[92]Prosser, *The Fall*, *supra* note 7, at 801-02. Another scholar has commented that Karl Llewellyn, the principal drafter of Article 2, was hostile to privity as a defense. 2 W. Hawkland, *supra* note 19, at § 2-318:01. *See also supra* note 90.

[93]*See* Frumer & Friedman, *supra* note 22, § 3.02[7][a] at 3-216 to 3-217; 2 R. Hursh & H. Bailey, American Law of Products Liability § 10.66 at 344 (2d ed. 1974) [hereinafter R. Hursh & H. Bailey]; G. Wallach, The Law of Sales under the Uniform Commercial Code ¶ 11.15[1][a] (1981) [hereinafter G. Wallach].

[94]*See* Richards v. Goerg Boat & Motors, Inc., 179 Ind. App. 102, 112, 384 N.E.2d 1084, 1092, *transfer denied* (1979). ("Generally privity extends to the parties to the contract of sale. It relates to the bargained for expectations of the buyer and seller.") *Accord* Ridge Co. v. NCR Corp., 597 F. Supp. 1239, 1242 (N.D. Ind. 1984); *see* Bepko, *Contracts, Commercial Law & Consumer Law, 1979 Survey of Recent Developments in Indiana Law*, 13 Ind. L. Rev. 107, 109 (1980).

v. Wright.[95] A more realistic appraisal of the contemporary marketplace reveals that the expectations of all of the parties in the chain of distribution are that the manufacturer will produce merchantable goods and will ultimately be liable if the goods in the hands of the retail buyer prove to be unmerchantable.

When the manufacturer produces his goods and puts them into the chain of distribution, his expectation is that they will ultimately reach a user, not gather dust on the shelves of a distributor or retailer. Unless the manufacturer is acting fraudulently, he further expects that the goods are fit for the ordinary uses to which such goods are put by buyers.[96] Many manufacturers engage in massive and very expensive advertising campaigns aimed directly at the retail buyer with the specific intention of creating a demand for their products.[97] Although, as already noted, the advertising may be crafted carefully so as not to constitute an express warranty,[98] no manufacturer would spend money on advertising if he did not fully expect the buyer to react to it and buy the product. The manufacturer's expectation and intention with respect to the parties who are between him and the buyer is to encourage the interest of those parties so that they, too, will promote sales of his product. In the vast majority of transactions today, the intermediate parties do nothing more than facilitate the flow of the goods from the manufacturer to the buyer.[99] The fact that the manufacturer does not deal directly and individually with each buyer is irrelevant to these expectations.[100] At the

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[95]152 Eng. Rep. 402 (1842). *See supra* discussion of this case and the business climate in which it arose, at notes 19-22 and accompanying text.

[96]*See* Speidel, *Warranty Theory*, *supra* note 19, at 44-47.

[97]*See* Lang v. General Motors Corp., 136 N.W.2d 805, 809-10 (N.D. 1965); R. Nordstrom, Handbook of the Law of Sales § 91 (1970).

[98]*See* U.C.C. § 2-313(2): "[A]n affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty."

[99]*See supra* notes 22-23 and accompanying text. In the few situations where the retail dealer is to perform some service on the goods, such as prepare an automobile for delivery or prepare and install industrial or consumer equipment, the manufacturer will have the opportunity to show that the damage was caused by improper service, rather than by a defect in the goods themselves. In most situations, however, the failure of goods to be merchantable, including those goods which require some preparatory service, occurs at the manufacturing level.

[100]*See* Speidel, *Warranty Theory*, *supra* note 19, in which Prof. Speidel states that the relationship between all of the parties in the chain of distribution is sufficient under modern contract theory to support the buyer's action against the remote manufacturer despite the absence of traditional privity. *Cf.* Carlill v. Carbolic Smoke Ball Co., [1893] 1 Q.B. 256, the famous case in which a manufacturer was held liable on a promise in newspaper advertising to pay 100 pounds to anyone who contracted a cold or influenza after using the carbolic smoke ball. The offer was made to the general public and did not require notice of acceptance to the offeror.

same time, the wholesale distributor and the retailer expect that the manufacturer has sold them merchantable goods, and that no one will have cause to complain.

The buyer's expectations are that the goods will be fit for their ordinary purposes and that if they are not, the manufacturer whose advertising was seen or whose brand is on the goods will stand behind them. There is nothing inconsistent with the expectations of any of the parties if the responsibility for unmerchantable goods is placed precisely where it belongs, on the manufacturer. Moreover, the basic expectations of the parties are precisely the same in the absence of advertising or knowledge of the identity of the manufacturer at the time of the sale. All parties in the chain expect that the goods will be suitable for their ordinary purposes.

The policy which supports elimination of a privity requirement in implied warranty actions is quite straightforward. The party who can best assure that the goods are merchantable is the manufacturer, particularly when the distributor and retail dealer who stand between the manufacturer and the buyer in the chain of distribution do nothing more than pass the goods on to the buyer unchanged, frequently in a sealed package. If the goods are unmerchantable, the manufacturer is not only the party ordinarily responsible for the problem but is also the party most able to prevent or correct it.

Furthermore, under Code procedures, if the implied warranty of merchantability has been breached and the buyer sues her immediate seller, the likelihood is that responsibility will ultimately fall on the manufacturer, a fact also within its expectation. If the buyer sues the retail dealer for breach of warranty, the dealer may move up the vertical chain of distribution by using local third-party practice or by "vouching in" his immediate seller (the distributor) pursuant to the U.C.C., and so on up the line, until the manufacturer is vouched in.[101] Should vouched-in parties not come in and defend, and the court finds that the goods, as manufactured, were unmerchantable, that finding of fact will be binding in later litigation with the vouched-in parties who refused to appear.[102] Third-party practice or vouching-in, however, is "expensive,

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[101]*See* U.C.C. § 2-607(5):

> Where the buyer [here, the retailer] is sued for breach of a warranty or other obligation for which his seller is answerable over
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> (a) he may give his seller [here, the distributor or manufacturer] written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two litigations, then unless the seller after seasonable receipt of the notice does come in and defend he is so bound.

[102]*Id.*

time consuming, and wasteful."[103] It promotes multiplicity of actions and wastes valuable judicial resources.[104]

It may be argued that the availability of this vouching-in procedure prevents the privity requirement from causing any real harm to buyers who can always sue their immediate sellers, except in the few cases where the seller is judgment-proof or out of business.[105] Unfortunately for the buyers in *Candlelight Homes*,[106] theirs was one of the cases in which the dealer was out of business so they recovered nothing. The unavailability of the immediate seller is not all that rare.[107]

The result of barring a direct suit against the manufacturer is that the manufacturer of unmerchantable goods who is fortunate enough to have his goods sold by an economically shaky, irresponsible or judgment-proof entity somewhere in the chain of distribution between him and the retail buyer will enjoy the windfall of no liability if he hides behind the wall of privity.[108] A clearer case of unjust enrichment is difficult to imagine.[109] Also, if the manufacturer is not a party to the suit and cannot be joined involuntarily or vouched in because of the absence of

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[103]Prosser, *The Assault*, *supra* note 5, at 1131-33.

[104]*See, e.g.*, Morrow v. New Moon Homes, Inc., 548 P.2d 279 (Alaska 1976); R. Nordstrom, *supra* note 97, § 91.

[105]*See* Szajna v. General Motors Corp., 115 Ill. 2d 294, 301, 503 N.E.2d 760, 765 (1986) (in which the court observed that an automobile dealer is usually a responsible commercial entity and that the unavailability of the dealer occurs "infrequently"); R. Nordstrom, *supra* note 97, § 91.

[106]414 N.E.2d 980 (Ind. Ct. App. 1981). *See supra* notes 2, 57-59 and accompanying text.

[107]*See, e.g.*, Ford Motor Credit Co. v. Harper, 671 F.2d 1117 (8th Cir. 1982) (tractor seller out of business); Morrow v. New Moon Homes, Inc., 548 P.2d 279 (Alaska 1976) (mobile home seller out of business); Durfee v. Rod Baxter Imports, Inc., 262 N.W.2d 349 (Minn. 1977) (auto dealer out of business). In 1984 and 1985, respectively, 13,787 and 13,418 (preliminary figure) retail businesses failed; 4,882 and 4,813 (preliminary figure) wholesale businesses failed. U.S. Bureau of the Census, Statistical Abstract of the United States: 1987, Table No. 866, p.510 (1986).

During the preparation of this article, one of the author's students came to him with the following problem which she was requested to research by the Indianapolis law firm for which she was working: the buyer of a truck seat was seriously injured in an accident, partly, he claimed, because the seat was defective. Because the statute of limitations for strict products liability or negligence had expired, he sued the retailer (represented by the student's law firm employer) for breach of implied warranty of merchantability. Unfortunately for the retailer, with whom the injured buyer was in privity, the wholesaler from whom the retailer purchased the seat is out of business. Under current Indiana law, because there is no privity between either the buyer or the retailer and the manufacturer, the retailer may be required to bear the personal injury damages which should be the responsibility of the manufacturer if the seat in fact was defective.

[108]*See* Industrial Graphics, Inc. v. Asahi Corp., 485 F. Supp. 793 (D. Minn. 1980); Speidel, *Warranty Theory*, *supra* note 19, at 47.

[109]*See* Speidel, *Warranty Theory*, *supra* note 19, at 46.

privity with the retailer, it is unfair to impose on the retailer the cost of first litigating as a defendant with the buyer and then as a plaintiff with the distributor a claim which ultimately will be the responsibility of the manufacturer. If there is no break in the chain of distribution, the retailer may be able to recover most of his losses from the party immediately above the retailer in the chain, but the cost to him in terms of both time and money, particularly if he must pay an award for personal injuries or property damage, may be an unreasonable or impossible burden for the retailer to bear, even if only temporarily. And, if there is a break in the chain immediately above him, the retailer must bear the entire cost.[110]

In a case strikingly similar to *Candlelight Homes*, the Arizona Supreme Court imposed the privity barrier between the buyers of a woefully defective mobile home and its manufacturer, and stated rather cavalierly the philosophy underlying the vertical privity requirement in implied warranty cases: "In short, we believe that a buyer should *pick his seller with care* and recover any economic loss from that seller . . . ."[111] The court surely could not have meant that any buyer of a mobile home, an automobile, or other equipment of major cost should first obtain a favorable, current credit report on her seller before completing the purchase in order to be protected, or did it? It seems so. It requires little imagination to realize the impossibility of this task for the buyer of a family mobile home or of an office copying machine. The blunderbuss of *caveat emptor*, one of the weapons which the implied warranty of merchantability was designed to neutralize with respect to product quality, fires anew from the tower of vertical privity. In a business climate replete with the failure of retail businesses,[112] the burden of unmerchantability should be placed where it belongs, on the manufacturer, not on the buyer who unknowingly selected a failing retailer or on the retailer who dealt with an insolvent distributor. What buyer, for example, could have foreseen the demise of retailing giant W.T. Grant? Yet the courts requiring privity demand such foresight. The better policy was expressed in the context of a buyer's attempt to revoke acceptance[113] against a remote importer-distributor of a defective automobile: "A

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[110]*See supra* note 107.

[111]Flory v. Silvercrest Indus., Inc., 129 Ariz. 574, 580, 633 P.2d 383, 389 (1981) (emphasis added); *accord* Hole v. General Motors Corp., 83 A.D.2d 715, 716, 442 N.Y.S.2d 638, 640 (1981); State *ex rel.* Western Seed Prod. Corp. v. Campbell, 250 Or. 262, 267, 442 P.2d 215, 217 (1968), *cert. denied*, 393 U.S. 1093 (1969); White & Summers, *supra* note 8, § 11-6, at 410; *see* James Sausage Co. v. Novalco, Inc., 17 U.C.C. Rep. Serv. (Callaghan) 1027, 1034 (Okla. Ct. App. 1975).

[112]*See* statistics cited *supra* note 107.

[113]*See* U.C.C. § 2-608.

consumer cannot be expected to foresee the demise of local dealerships; instead he is entitled to rely on the distributor who induced him to buy the automobile."[114]

In many jurisdictions, the success of the assault on privity depends to a large extent on the type of injury for which particular damages are being sought: personal injury, direct property damage caused by the unmerchantable goods, loss of bargain from the failure of the goods themselves, or consequential economic loss, such as loss of profits.[115] As a matter of fairness and practicality, the type of damages sought should be no impediment to the success of the assault.

Today, most actions involving personal injury or property damage in Indiana are based on the Product Liability Act,[116] which imposes strict liability upon all sellers of defective products that cause personal injury or property damage regardless of a lack of vertical or horizontal privity.[117] The Product Liability Act does not supersede the Code, however, so actions for personal injuries resulting from a breach of any Code warranty are still available.[118]

As one Indiana judge has observed: "The modern trend is to reject the privity requirement" in all cases involving personal injury because privity is of " 'no consequence' " in such cases.[119] It appears that the

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[114]Durfee v. Rod Baxter Imports, Inc., 262 N.W.2d 349, 358 (Minn. 1977).

[115]*See* White & Summers, *supra* note 8, § 11-2.

[116]Ind. Code § 33-1-1.5 (1982 and Supp. 1987); *see* White & Summers, *supra* note 8, § 11-3.

[117]*See* Ind. Code § 33-1-1.5-3 (Supp. 1987):

> (a) One who sells, leases or otherwise puts into the stream of commerce any product in a defective condition unreasonably dangerous to any user or consumer or to his property is subject to liability for physical harm caused by that product to the user or consumer or to his property if that user or consumer is in the class of persons that the seller should reasonably foresee as being subject to the harm caused by the defective condition, and, if:
> (1) the seller is engaged in the business of selling such a product; and
> (2) the product is expected to and does reach the user or consumer without substantial alteration in the condition in which it is sold by the person sought to be held liable under this chapter.
> (b) The rule stated in subsection (a) applies although:
> (1) the seller has exercised all reasonable care in the preparation, packaging, labeling, instructing for use, and sale of this product; and
> (2) *the user or consumer has not* bought the product from or *entered into any contractual relation with the seller.*

(Emphasis added.)

See Citizens Gas & Coke Utility v. American Economy Ins. Co., 486 N.E.2d 998 (Ind. 1985); Whittaker v. Federal Cartridge Corp., 466 N.E.2d 480 (Ind. Ct. App. 1984).

[118]*See* Ind. Code § 33-1-1.5-1 (Supp. 1987); Thiele v. Faygo Beverage, Inc., 489 N.E.2d 562 (Ind. Ct. App. 1986).

[119]Lane v. Barringer, 407 N.E.2d 1173, 1178 (Ind. Ct. App. 1980) (Ratliff, J.,

"modern trend" has in fact become the majority position. In most jurisdictions vertical privity between an injured party and a remote manufacturer need not be shown in a suit for personal injuries or property damage caused by a breach of the implied warranty of merchantability.[120]

That a plaintiff, such as Mrs. Lane in *Lane v. Barringer*,[121] has four years to bring a U.C.C. warranty action[122] rather than two years for a products liability or negligence action[123] does nothing to upset the expectations of the manufacturer. In implied warranty cases, the time begins to run on delivery of the goods to the buyer, whether the defect is or is not discoverable.[124] In negligence or products liability cases, the limitation period begins to run from the time of the injury.[125] And under the Product Liability Act, suit may be brought against a manufacturer up to ten years after delivery of his product to the initial user, usually the retail buyer.[126] Thus, it is possible for the four year statute of limitations under the Code to expire before the occurrence of any personal injury or property damage, in which case an action to recover for that injury or damage will be barred. Yet there may still be an action for negligence or under the Product Liability Act for an additional six years. A manufacturer knows that under Indiana law, he is exposed to the possibility of liability for approximately ten years after he produces and

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concurring in part, dissenting in part) (quoting Berry v. G.D. Searle & Co., 56 Ill. 2d 548, 558, 309 N.E.2d 550, 556 (1974)). Judge Ratliff concurred in the judgment against the plaintiff only because she was not within the protection of U.C.C. § 2-318 in the horizontal line. *See supra* notes 50-56 and accompanying text. *Lane* is an unusual case because the plaintiff had allowed the two year statute of limitations for tort actions, including strict products liability, to expire. The only remedy still available for the personal injury she suffered was under the U.C.C. for breach of implied warranty of merchantability which, according to two judges of the court of appeals, required vertical privity.

[120]*See, e.g.*, Berry v. G.D. Searle & Co., 56 Ill. 2d 548, 309 N.E.2d 550 (1974); 2 Frumer & Friedman, *supra* note 22, §§ 3.02[6] at 3-194, 3.02[7][a] at 3-216 to 3-217; 2 R. Hursh & H. Bailey, *supra* note 93, § 10.6, at 344; G. Wallach, *supra* note 93, ¶ 11.15[1][a].

[121] 407 N.E.2d 1173 (Ind. Ct. App. 1980).

[122]*See* U.C.C. § 2-725(1).

[123]The limitation on a products liability action is two years from the date of the injury, but no action may be brought more than ten years "after the delivery of the product to the initial user or consumer." Product Liability Act, Ind. Code § 33-1-1.5-5 (Supp. 1987). The limitation on ordinary negligence actions involving personal injury or property damage is two years. Ind. Code § 34-1-2-2(1) (1982).

[124]*See* U.C.C. § 2-725(2); Stumler v. Ferry-Morse Seed Co., 644 F.2d 667 (7th Cir. 1981). An exception is if the warranty expressly extends to future performance, § 2-725(2), but that involves express, not implied, warranties. *See* H. Greenberg, *supra* note 26, § 14.34.

[125]*See* Dague v. Piper Aircraft Corp., 275 Ind. 520, 418 N.E.2d 207 (1981); Wojcik v. Almase, 451 N.E.2d 336 (Ind. Ct. App. 1983).

[126]*See* Ind. Code § 33-1-1.5-5 (Supp. 1987); *see also supra* note 123.

distributes his goods. Allowing recovery from a remote manufacturer for breach of a Code warranty therefore does nothing whatever to change that expectation of possible exposure.

The cases are more evenly divided when the damages sought are economic in nature.[127] Such damages may be of two distinct types. The first type, direct damages or loss of bargain damages, results from the effect of the unmerchantability of the goods on the value of the goods themselves. The buyer simply did not get what he bargained for. The second, consequential damages such as loss of profits, results from the buyer's inability to use the goods as expected.[128] Although the majority of courts apparently do not yet permit buyers to recover either type of economic damages from remote manufacturers without privity,[129] the number of jurisdictions allowing such damages in non-privity situations is increasing,[130] and the majority of writers on the subject consider privity to be an illogical, antiquated requirement which should be eliminated as a requirement in all warranty cases regardless of the type of damages sought.[131]

If the goods are not worth what the buyer paid because of a nonconformity attributable to the manufacturer, there is no reason why, privity or no privity, that the manufacturer should be insulated from responsibility for that economic damage to the buyer. That responsibility

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[127]*See* G. Wallach, *supra* note 93, ¶ 11.15[1][a].

[128]*See* Morrow v. New Moon Homes, Inc., 548 P.2d 279 (Alaska 1976); White & Summers, *supra* note 8, § 11-5. One writer calls these "repair loss"—the cost of repair or replacement when the product self-destructs without harming anything else—and "expectation loss"—the loss of use of the product. Franklin, *When Worlds Collide: Liability Theories and Disclaimers in Defective-Product Cases*, 18 Stan. L. Rev. 974, 981 (1966).

[129]*See* White & Summers, *supra* note 8, at §§ 11-5, 11-6.

[130]*See, e.g.*, Morrow v. New Moon Homes, Inc., 548 P.2d 279 (Alaska 1976); Spring Motors Distribs., Inc. v. Ford Motor Co., 98 N.J. 555, 489 A.2d 660 (1985); Comment, *Rights of Remote Sellers*, *supra* note 29, at 881. In their first edition, White & Summers characterized the courts awarding economic damages as "a healthy minority." J. White & J. Summers, Handbook of the Law under the Uniform Commercial Code § 11-5 (1972).

[131]*See, e.g.*, Williston on Sales, *supra* note 10, § 22-5, at 167-68; Edmeades, *supra* note 12; Rabin & Grossman, *supra* note 87; Razook, *The Ultimate Purchaser's and Remote Seller's Guide through the Code Defenses in Product Economic Loss Cases*, 23 Am. Bus. L.J. 84 (1985); Schwartz, *Economic Loss in American Tort Law: The Examples of* J'Aire *and of Products Liability*, 23 San Diego L. Rev. 37 (1986); Speidel, *Warranty Theory*, *supra* note 19 at 24-25; *but see, e.g.*, White & Summers, *supra* note 8, at §§ 11-5, 11-6; Prosser, *The Assault*, *supra* note 5, at 1124-34. One writer has suggested that during Dean Prosser's service in the assault on the citadel of privity, he "was a secret agent serving its defenders," and "completed his undercover mission for the defenders of the citadel by openly advocating that there should be no liability to the out-of-privity plaintiff for products which only caused him economic loss." Edmeades, *supra*, at 648-49.

is certainly within his expectations.[132] The buyer expects merchantable goods; the manufacturer expects his goods to be merchantable. As stated by the Michigan Court of Appeals:

> On principle the manufacturer should be required to stand behind his defectively-manufactured product and held to be accountable to the end user even though the product caused neither accident nor personal injury. The remote seller should not be insulated from direct liability where he has merely mulcted the consumer.[133]

Nor will the remote manufacturer be liable for more than he should be; the provisions of the Code protect him. For example, it has been suggested that the manufacturer should not be responsible to the buyer for the difference between the retail price paid by the buyer and the actual value of the unmerchantable goods,[134] apparently because the manufacturer received less than the retail price from the retailer or wholesaler who purchased the goods from him.[135] But that is exactly the amount for which the manufacturer ultimately should be and will be liable if there is no break in the chain of distribution.[136]

For example, assume that the wholesale price paid by Retailer to Manufacturer is $50 and the retail price paid by Buyer is $100. If the goods are completely worthless because of their nonconformity, Buyer's loss of bargain damage is $100. If Buyer sues Retailer, Buyer will recover $100. If Retailer impleads or vouches in Manufacturer[137] or brings a separate suit against Manufacturer, Retailer's damages are $100, which consist of the $50 he paid to Manufacturer for the worthless goods plus the consequential damage of $50 in profit he lost because of that worthlessness.[138]

Similarly, if a remote seller sells used goods to the retailer who then sells them as new to the buyer for considerably more money than he would have charged for used goods,[139] the remote seller should not suffer

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[132]*See supra* text accompanying notes 94-100.

[133]Cova v. Harley Davidson Motor Co., 26 Mich. App. 602, 609, 182 N.W.2d 800, 804 (1970); *see* Speidel, *Warranty Theory*, *supra* note 19, at 46.

[134]The Code's measure of damages for breach of warranty is "the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted." U.C.C. § 2-714(2). The buyer may also recover incidental and consequential damages. U.C.C. § 2-714(3). Presumably, the retail price will be the value of the goods if they had been as warranted, *i.e.*, merchantable.

[135]WHITE & SUMMERS, *supra* note 8, § 11-5, at 409.

[136]*See* Ribstein, *Guidelines for Deciding Product Economic Loss Cases*, 29 MERCER L. REV. 493, 521-22 (1978).

[137]*See supra* notes 101-102 and accompanying text.

[138]*See* U.C.C. §§ 2-714, 2-715(2)(a).

[139]*See* WHITE & SUMMERS, *supra* note 8, § 11-5, at 409, where they pose this problem as another justification for not awarding loss of bargain damages in the absence of privity.

because of the retailer's misrepresentation or fraud. For the purposes of calculating damages under section 2-714, the value of the goods as warranted should be based on whose implied warranty of merchantability is being enforced. If it is the implied warranty of the remote seller, the "as warranted" value used in the calculation should be of merchantable, *used* goods as impliedly warranted by the remote seller, not the value of new goods as either expressly or impliedly warranted by the misrepresentation of the retailer. The misrepresentation should not be imputed to the remote seller without more facts that connect him to the retailer, such as actual or apparent authority.

Furthermore, allowing buyers to recover loss of bargain damages will not subject the manufacturer to unreasonably large or unpredictable damages. The upper limit on the manufacturer's exposure for this type of damage is the retail value of the goods, a figure well within the manufacturer's contemplation. A manufacturer who markets a product which is not fit for its ordinary uses should be responsible to every buyer who purchased one. Anything less would be unfair to the buyers and a windfall to the manufacturer.

The argument against allowing recovery of consequential economic damages, such as lost profits, from a remote manufacturer is that "[r]emote buyers may use a seller's goods for unknown purposes from which enormous losses might ensue."[140] This sounds remarkably similar to the argument made in *Winterbottom*[141] where the privity barrier was first constructed more than a century ago. But section 2-715 of the Code allows only the recovery of consequential economic damages "resulting from general or particular requirements and needs *of which the seller at the time of contracting had reason to know* and which could not reasonably be prevented by cover or otherwise. . . ."[142] This gives the manufacturer or other remote seller two important protections that cannot be ignored. First, the buyer's damages must be foreseeable.[143] A buyer's unknown or unpredictable requirements or needs can result only in damages that are not foreseeable. The warranty of merchantability extends only to ordinary purposes which, by definition, are known to the manufacturer.[144]

Second, the requirement that the buyer attempt to mitigate her damages "by cover or otherwise" or be precluded from recovering

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[140]White & Summers, *supra* note 8, § 11-6, at 410.

[141]Winterbottom v. Wright, 152 Eng. Rep. 402 (1842); *see supra* text accompanying notes 19-21.

[142]U.C.C. § 2-715(2)(a) (emphasis added).

[143]*See* H. Greenberg, *supra* note 26, § 24.15; White & Summers, *supra* note 8, § 10-4.

[144]*See* Speidel, *Warranty Theory*, *supra* note 19, at 50.

consequential damages[145] limits the ultimate liability of the remote manufacturer. For example, a manufacturer of a seed planting machine expects that it will plant seeds. If the machine does not plant properly,[146] the manufacturer should reasonably foresee that the farmer-buyer who uses the defective planter may lose part or all of his crop for that season. However, if, before the end of planting time, the farmer realizes that the planter is not operating properly, the farmer's failure to mitigate his damages by borrowing, renting, or buying another planting machine may preclude him from recovering his consequential damages from any defendant,[147] including the retailer with whom he is in privity.

The Indiana Supreme Court squarely addressed the issue of consequential economic damages in *Barnes v. Mac Brown & Co.*,[148] where it stated, in the context of the implied warranty of habitability:

> The contention that a distinction should be drawn between mere "economic loss" and personal injury is without merit. Why there should be a difference between an economic loss resulting from injury to property and an economic loss resulting from personal injury has not been revealed to us. When one person is personally injured from a defect, he recovers mainly for his economic loss. Similarly, if a wife loses a husband because of injury resulting from a defect in construction, the measure of damages is totally economic loss. We fail to see any rational reason for such a distinction.[149]

Having made this observation, the court held that the second purchaser of a dwelling could recover for breach of the implied warranty of habitability the cost of repairing and waterproofing the cracked walls of a damp basement despite the lack of privity with the builder-defendant. The comment by the same court nine years later, "We see no reason to extend the exception to the privity rule any further in this case or others not involving personal injury,"[150] contradicted the reasoning in

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[145]*See* U.C.C. § 2-715(2)(a) and Official Comment 2.

[146]*See* Dutton v. International Harvester Co., 504 N.E.2d 313 (Ind. Ct. App.), *transfer denied* (1987).

[147]*See* U.C.C. § 2-715(2)(a); White & Summers, *supra* note 8, § 10-4, at 395-96; *The Citadel Stands*, *supra* note 12, at 678-80. Professor Edmeades suggests that courts are often stingy in awarding consequential damages because of their inherently speculative nature. *See id.*

[148]264 Ind. 227, 342 N.E.2d 619 (1976). *See supra* notes 65-69 and accompanying text.

[149]*Id.* at 230, 342 N.E.2d at 621.

[150]Citizens Gas & Coke Utility v. American Economy Ins. Co., 486 N.E.2d 998, 1001 (Ind. 1985).

Barnes and was both short-sighted and substantially broader than required in the case before the court.[151]

If the theoretical basis for continuing the privity requirement in all warranty cases is to protect remote manufacturers from unpredictable or catastrophic damage awards, as it purports to be, then no recovery whether for personal injury or economic loss, in warranty or strict liability, should be recoverable, and *Winterbottom*[152] should again reign supreme. Abolishing the privity requirement only in personal injury or property damage cases, as has occurred in most states,[153] also conflicts with this theoretical basis for the privity defense. The exposure of a manufacturer to liability for personal injury or direct property damage can be far more unpredictable and far more devastating than exposure to liability for economic loss.[154] If the defective seed planting machine,[155] instead of merely not planting the farmer's crop, had thrown and seriously injured or killed him, and then ran wildly through his barn, destroying it and the animals in it, the damages could far exceed what the manufacturer might be required to pay to replace a defective machine or a lost crop.

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[151]*Citizens Gas* involved horizontal, rather than vertical, privity. The plaintiffs were the purchasers of a residence from a prior homeowner who had a gas water heater installed by the gas company and had also executed a waiver of the applicable plumbing code requirements in order have the heater installed as requested. As a consequence of the code violation, the heater later malfunctioned, flooded the plaintiffs' home, and caused approximately $12,000 in property damage but no personal injury. The court based its ruling against plaintiffs on the absence of privity with the gas company, but could just as well have decided that the only warranty to which plaintiffs were entitled was the warranty which their predecessor on the horizontal line had received, as limited by the waiver.

See also Essex v. Ryan, 446 N.E.2d 368, 372 (Ind. Ct. App. 1983), in which the court grudgingly conceded that *Barnes* was not limited to personal injury but added that personal injury was a significant factor in *Barnes*. In Sanco v. Ford Motor Co., 771 F.2d 1081 (7th Cir. 1985), the court ruled that although the majority in *Barnes* rejected the requirement of privity in warranty cases involving either personal injury or economic loss, Indiana courts would continue to deny recovery of purely economic losses in negligence actions.

[152]152 Eng. Rep. 402 (1842), discussed *supra* notes 19-21 and accompanying text.

[153]*See supra* note 120 and the accompanying text.

[154]*See* Schwartz, *Economic Loss in American Tort Law: The Examples of* J'Aire *and of Products Liability*, 23 San Diego L. Rev. 37, 60-61 (1986), in which the writer suggests that in very large economic loss cases, the buyer will usually have dealt directly with the manufacturer rather than with someone lower in the chain of distribution, thereby establishing privity. With the purchase of more ordinary products by consumers, "and even businesses can be consumers in the sense that they buy and use products about which they cannot bargain and have little expertise", the ultimate economic loss will be small but the personal injury loss can be staggering.

[155]*See* Dutton v. International Harvester Co., 504 N.E.2d 313 (Ind. Ct. App.), *transfer denied* (1987).

Furthermore, if the theoretical basis for eliminating privity as a requirement in personal injury or direct property damage cases is "humanitarian," as it seems to be,[156] the emphasis is misplaced. A farmer's loss of a season's crop,[157] or the inability of a small business to use a truck[158] or a computer system[159] can have far more disastrous consequences to the buyer than a broken arm or leg. Yet for such physical injuries, damages would be available from the manufacturer in a products liability action or in the majority of jurisdictions which permit recovery for personal injuries resulting from breach of a U.C.C. warranty in the absence of privity.[160]

2. *The Implied Warranty of Fitness for Particular Purpose.*—Like the express warranty, the implied warranty of fitness for particular purpose requires some affirmative conduct on the part of the person who makes the warranty: the buyer must have a particular purpose for the goods, usually something other than the ordinary purpose;[161] the seller must have reason to know the buyer's particular purpose; the seller must have reason to know that the buyer is relying on the seller's expertise to furnish goods suitable for that purpose; and the buyer must in fact rely on the seller.[162] If any of these elements is missing, the warranty does not exist. Unlike the implied warranty of merchantability which arises automatically if the seller is a merchant who deals in the kind of goods involved,[163] not every sale by a merchant creates the implied warranty of fitness, nor is it necessary that the warrantor of fitness for particular purpose be a merchant for the warranty to exist.[164]

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[156]*See* Citizens Gas & Coke Utility v. American Economy Ins. Co., 486 N.E.2d 998, 1001 (Ind. 1985).

[157]*See Dutton*, 504 N.E.2d 313.

[158]*See* Sanco v. Ford Motor Co., 771 F.2d 1081 (7th Cir. 1985).

[159]*See* Ridge Co. v. NCR Corp., 597 F. Supp. 1239 (N.D. Ind. 1984).

[160]*See supra* text accompanying notes 119-120.

[161]Whether the particular purpose of the buyer must be different from the ordinary purpose for which the goods are used is a matter of debate. U.C.C. Section 2-315, Official Comment 2, suggests that the implied warranty of fitness for particular purpose relates to uses peculiar to the buyer and the implied warranty of merchantability relates to the ordinary uses of the goods. *See, e.g.*, H. Greenberg, *supra* note 26, § 14.21; White & Summers, *supra* note 8, § 9-9 n.21; Lord, *Some Thoughts about Warranty Law: Express and Implied Warranties*, 56 N.D.L. Rev. 509, 608-15 (1980).

[162]*See* U.C.C. § 2-315:

> Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

[163]*See* U.C.C. § 2-314(1).

[164]*See* U.C.C. § 2-315, Official Comment 4.

A case in which a manufacturer makes an implied warranty of fitness for particular purpose without there being some connection between the warranting manufacturer and the retail buyer is exceedingly rare.[165] In the usual situation which gives rise to the existence of this warranty, the manufacturer and the buyer will have communicated with each other with respect to the buyer's particular needs. This being so, the manufacturer will have "participated in the sale," thereby establishing privity or an exception to it.[166]

There arguably might not be a direct connection between the manufacturer and the buyer when the buyer states his needs to a dealer who, in turn, relates those needs to the manufacturer and relies on the manufacturer to furnish goods which will meet the buyer's particular needs. In such a situation, however, there is still likely to be an exception to the privity requirement on one of two bases: (1) in relating the particular needs to the manufacturer, and only for that purpose, whether the dealer discloses the identity of the buyer or not, the dealer is acting as the agent of the buyer;[167] (2) the promise of the manufacturer to furnish goods which meet the particular needs of a particular buyer, as related to him by the dealer, is a third-party beneficiary contract in which the buyer is the intended beneficiary.[168] In either case, the principles of agency law or third party beneficiary contract law should furnish the necessary privity or surmount its barrier.

As with the giving of an express warranty, unless the dealer has the actual or apparent authority to make warranties on behalf of the manufacturer, any implied warranty of fitness made by the dealer should

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[165]*See* Rabin & Grossman, *supra* note 87, at 37-38; Comment, *Rights of Remote Sellers*, *supra* note 29, at 897-898.

[166]*See* Richards v. Goerg Boat & Motors, Inc., 179 Ind. App. 102, 384 N.E.2d 1084, *transfer denied* (1979), and the discussion, *supra*, at note 78 and accompanying text.

[167]*See* Pawlec v. Digiticom, Inc., 192 N.J. Super. 474, 477 n.1, 471 A.2d 60, 62 n.1 (1984).

[168]*But see* Hixon v. Sherwin-Williams Co., 671 F.2d 1005 (7th Cir. 1982). The court said that to hold that an insurance company which hired a contractor to replace an insured's damaged linoleum floor was the third-party beneficiary of a contract between the contractor and a subcontractor who failed to follow instructions on use of the glue was "a transparent effort to evade the privity requirement; if it prevailed, the requirement would be meaningless." *Id.* at 1010. *Cf.* Davidson v. John Deere & Co., 644 F. Supp. 707 (N.D. Ind. 1986), which involved an express warranty claim by a personal representative whose decedent was killed while using equipment purchased by his employer. The court observed that because Indiana has adopted U.C.C. § 2-318, Alternative A, no one other than the persons enumerated therein can be a third party beneficiary of the contract between the seller and the buyer. Although this case dealt only with horizontal privity, a court could conceivably take the same position with respect to vertical privity despite the position of the drafters that the section is neutral on the issue. U.C.C. § 2-318, Official Comment 3. *See supra*, notes 30-32 and accompanying text.

not be attributable to or the responsibility of the manufacturer. The absence of the required element of the manufacturer's reason to know the buyer's particular purpose, whatever the basis for that lack of reason to know, is fatal to the existence of such a warranty from the manufacturer.

It follows, therefore, that if the buyer is able to show that there is an implied warranty of fitness for particular purpose and that the warranty was made by the manufacturer, it will be almost impossible for the manufacturer to show that there was no privity with the buyer or an exception thereto. And once the warranty and its breach have been established, the buyer-plaintiff is entitled to the full range of remedies granted by the Code.

One difficulty that may arise is that the Indiana courts, both federal and state, seem to lump the implied warranty of fitness with the implied warranty of merchantability under the label "implied warranties," without distinguishing between them or considering their specific elements. In *Richards v. Goerg Boat & Motors, Inc.*,[169] the court flatly stated, without considering how the two warranties differ, "[I]mplied warranties of merchantability and fitness for a particular use, as they relate to economic loss from the bargain, cannot ordinarily be sustained between the buyer and a remote manufacturer."[170] In another case, the court concluded that "the particular purpose of a passenger automobile is to drive on the public streets and highways safely without uncontrolled and unsafe behavior," and that the implied warranty of fitness had been breached.[171] And in *Candlelight Homes*, the court noted that the amended complaint referred only to the "implied warranty of fitness,"[172] but the court treated the case as if it involved the implied warranty of merchantability.[173]

The analysis of these courts is incorrect. As demonstrated above, if the facts show that there is an implied warranty of fitness attributable to the manufacturer, no matter how far up the chain of distribution, there is a connection between the manufacturer and the buyer that should

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[169]179 Ind. App. 102, 384 N.E.2d 1084 *transfer denied* (1979).

[170]179 Ind. App. at 112, 384 N.E.2d at 1092; *accord* Dutton v. International Harvester Co., 504 N.E.2d 313, 315 (Ind. Ct. App.) *transfer denied* (1987).

[171]Karczewski v. Ford Motor Co., 382 F. Supp. 1346, 1351 (N.D. Ind. 1974), *aff'd mem.*, 515 F.2d 511 (7th Cir. 1975). The federal court incorrectly concluded, without *Lane v. Barringer* or *Candlelight Homes* yet decided, that Indiana state courts would not require privity in an action for personal injuries resulting from a breach of warranty under the Uniform Commercial Code.

[172]414 N.E.2d at 981.

[173]The facts stated in the opinion do not support the existence of the fitness warranty, much less its breach. Thus, the result reached by the Indiana Court of Appeals, judgment in favor of the manufacturer, was probably correct but the court's analysis was flawed.

support a finding of privity or an exception to the privity requirement.

If the Indiana courts distinguish between the implied warranties of merchantability and of fitness for particular purpose, as they should, then a careful analysis of the facts in future cases would eliminate privity as a barrier in actions for breach of the implied warranty of fitness for particular purpose. Thus, the principal task of a damaged buyer will be to prove the existence of the warranty and its breach.

3. *Protection for the Manufacturer or Other Remote Seller.*—Contrary to the arguments of the defenders of the privity citadel, permitting a buyer to recover from a remote manufacturer or other remote seller does not convert that seller into an insurer. As discussed earlier, even if the remote manufacturer does nothing more than market his goods, he will not be liable for any damages peculiar to a particular buyer unless the seller knows or has reason to know of the buyer's needs. To be recoverable, the damages must be reasonably foreseeable.[174] If the buyer misuses the goods or puts them to some extraordinary or unusual use, the seller should not be liable for any of the resulting damages.[175] Furthermore, if the buyer could have avoided the claimed consequential damages by mitigating her losses but failed to do so, the consequential damages will not be recoverable.[176]

The Code also furnishes other protections to the seller, some of which the seller must affirmatively invoke, others of which are built into any Code transaction. The most important of these from the viewpoint of a seller or manufacturer is the ability to modify or disclaim warranties and to limit liability for damages.[177] The manufacturer of new goods does not usually attempt to disclaim all warranties, although he may do so. A disclaimer of all warranties, express and implied, which must clearly be brought to the attention of the buyer in order to be effective,[178] will likely have a chilling effect on the buyer's desire to buy the product, a result that no manufacturer wants. More typically, the manufacturer will give the buyer an express warranty that the goods shall be free of defects for a specific period of time, will disclaim all other warranties, express and implied, will limit the buyer's remedies in case of defect to repair or replacement of defective parts exclusively, and will disclaim liability for any consequential damages, all of which the Code expressly permits.[179] By doing so, and if the manufacturer

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[174]*See* U.C.C. § 2-715(2). *See also supra* notes 140-154 and accompanying text.

[175]*See* H. Greenberg, *supra* note 26, § 14.29.

[176]*See* U.C.C. § 2-715(2)(a). *See also supra* text accompanying notes 141-47.

[177]*See* U.C.C. § 2-316 (exclusion or modification of warranties); § 2-719 (contractual modification or limitation of remedy).

[178]*See* U.C.C. § 2-316 and the Official Comments thereto.

[179]*See* U.C.C. §§ 2-316(2), 2-316(3), 2-719.

fulfills his promises, the expectations of all parties in the chain of distribution are fulfilled: the manufacturer gets his price; the intermediaries in the chain make their profit; the buyer gets goods that are defect free or at least an adequate remedy for any defect in the goods.[180] Only if the limitation of remedy fails of its essential purpose, meaning that it deprives the buyer of the benefit of his bargain, or is unconscionable, will the manufacturer be exposed to liability for all of the buyer's damages, possibly including consequential damages.[181]

If the buyer inspects the goods before entering into the contract of sale or refuses to do so on the seller's demand, there is no implied warranty with respect to defects which her inspection should have revealed to her.[182] Should the buyer fail to give notice of breach within a reasonable time after learning of it, she will be barred from any remedy whatever.[183] This is different from the running of the statute of limitations, discussed earlier,[184] in that the expiration of a reasonable time following breach can be much shorter than the four-year limitation. Moreover, the buyer-plaintiff must always sustain the burden of proof imposed upon any party claiming a breach of warranty: she must prove that the warranty was given by the particular defendant, that it was breached, and that the breach caused the damages claimed. The buyer's inability to prove any one of these elements will absolve the remote seller of any liability.

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[180]*See* U.C.C. § 2-719.

[181]*See* U.C.C. § 2-719(2), (3). Whether failure of essential purpose under § 2-719(2), thereby entitling a buyer to the full panoply of remedies given by the Code, also negates an otherwise valid disclaimer of liability for consequential damages is an issue on which the courts and the commentators are divided. The better view appears to be that if the limitation fails of its essential purpose, *all* damages become available to the buyer, including consequential damages. *Compare, e.g.*, Matco Mach. & Tool Co. v. Cincinnati Milacron Co., 727 F.2d 777 (8th Cir. 1984); Fargo Mach. & Tool Co. v. Kearney & Trecker Corp., 428 F. Supp. 364 (E.D. Mich. S.D. 1977); Durfee v. Rod Baxter Imports, Inc., 262 N.W.2d 349 (Minn. 1977) (consequentials may be recovered) *with* Chatlos Sys., Inc. v. National Cash Register Corp., 635 F.2d 1081 (3d Cir. 1980), *cert. dismissed*, 457 U.S. 1112 (1981); S.M. Wilson & Co. v. Smith Int'l, Inc., 587 F.2d 1363 (9th Cir. 1978); Stutts v. Green Ford, Inc., 47 N.C. App. 503, 267 S.E.2d 919 (1980) (consequentials may not be recovered). *See* H. Greenberg, *supra* note 26, § 15.23; White & Summers, *supra* note 8, § 12-10, at 469-70; Eddy, *On the "Essential" Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)*, 65 Cal. L. Rev. 28, 88-93 (1977); Special Project, *supra* note 9, at 239; Speidel, *Warranty Theory*, *supra* note 19, at 54-55 n.160.

[182]*See* U.C.C. § 2-316(3)(b). Whether a particular buyer should have discovered defects during an inspection will depend, to a great extent, on that buyer's expertise. An ordinary consumer will not be expected to discover defects which only an expert could detect. *See id.*, Official Comment 8.

[183]*See* U.C.C. § 2-607(3). What constitutes a reasonable time will be a factual issue dependent upon the identity and knowledge of the buyer as well as the circumstances surrounding the discovery of the breach. *See id.*, Official Comment 4.

[184]*See supra* notes 121-126 and accompanying text.

IV. Conclusion

Abandoning the court-created requirement of vertical privity in U.C.C. implied warranty cases will fix the responsibility for defective goods precisely where it belongs, on the party who is in fact responsible for that defect and who is best able to prevent it. Contrary to the arguments of those who hide behind privity's moss-encrusted walls, abandoning this archaic defense will neither leave remote parties defenseless nor will it expose them to any risk beyond those to which they are already exposed. Not to abandon privity, given the modern structure of sales transactions, is irrational, illogical, and can result in both hardship for a damaged buyer or intermediary and a windfall to a cowardly seller who insists on hiding in the citadel rather than taking responsibility for his goods. The time has come for Indiana to resume the assault and press on to ultimate demolition of the citadel.

Pre-Trial Discovery of Trial Preparation Materials Prepared, and Non-Testifying Experts Retained, in Anticipation of Prior Litigation

Andrew W. Hull*

I. Introduction

Although the scope of pretrial discovery is generally very broad, limitations do exist, particularly for trial preparation materials and facts known and opinions held by experts. Discovery of otherwise discoverable materials or information may be restricted or denied entirely because a party has prepared or developed the materials or information in anticipation of litigation. In *American Buildings Co. v. Kokomo Grain Co.*,[1] the Indiana Court of Appeals rendered one of the few published decisions by Indiana's appellate courts regarding the interpretation and application of Rule 26(B)(3),[2] pertaining to discovery of trial preparation materials,

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[1]506 N.E.2d 56 (Ind. Ct. App. 1987), *transfer denied*, September 14, 1987.

[2]Ind. R. Tr. P. 26(B)(3) provides:

> (3) Trial Preparation: Materials. Subject to the provisions of sub-division (B)(4) of this rule, a party may obtain discovery of documents and tangible things otherwise discoverable under subdivision (B)(1) of this rule and prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative (including his attorney, consultant, surety, indemnitor, insurer, or agent) only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of his case and that he is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of such materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.
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> A party may obtain without the required showing a statement concerning the action or its subject matter previously made by that party. Upon request, a person not a party may obtain without the required showing a statement concerning the action or its subject matter previously made by that person. If the request is refused, the person may move for a court order. The provisions of Rule 37(A)(4) apply to the award of expenses incurred in relation to the motion. For purposes of this paragraph, a statement previously made is
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> (a) a written statement signed or otherwise adopted approved by the person making it, or
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> (b) a stenographic, mechanical, electrical, or other recording, or a transcription thereof, which is a substantially verbatim recital or an oral statement by the person making it and contemporaneously recorded.

and Rule 26(B)(4),[3] pertaining to the discovery of experts retained in anticipation of litigation.[4] More importantly, the court's opinion became one of only a handful considering the discovery of materials developed or experts retained in anticipation of *prior* litigation.[5]

The court ruled that documents prepared in anticipation of prior litigation were protected under Rule 26(B)(3).[6] However, the court concluded that facts known and opinions held by experts retained in anticipation of prior litigation were not protected under Rule 26(B)(4).[7] This difference in the application of the two provisions within Rule 26

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[3]Ind. R. Tr. P. 26(B)(4) provides:

(4) Trial Preparation: Experts. Discovery of facts known and opinions held by experts, otherwise discoverable under the provisions of subdivision (B)(1) of this rule and acquired or developed in anticipation of litigation or for trial, may be obtained as follows:

(a)(i) A party may through interrogatories require any other party to identify each person whom the other party expects to call as an expert witness at trial, to state the subject matter on which the expert is expected to testify, and to state the substance of the facts and opinions to which the expert is expected to testify and a summary of the grounds for each opinion.

(ii) Upon motion, the court may order further discovery by other means, subject to such restrictions as to scope and such provisions, pursuant to subdivision (B)(4)(c) of this rule, concerning fees and expenses as the court may deem appropriate.

(b) A party may discover facts known or opinions held by an expert who has been retained or specially employed by another party in anticipation of litigation or preparation for trial and who is not expected to be called as a witness at trial, only as provided in Rule 35(B) or upon a showing of exceptional circumstances under which it is impracticable for the party seeking discovery to obtain facts or opinions on the same subject by other means.

(c) Unless manifest injustice would result,

(i) the court shall require that the party seeking discovery pay the expert a reasonable fee for time spent in responding to discovery under subdivision (B)(4)(a)(ii) and (B)(4)(b) of this rule; and

(ii) with respect to discovery obtained under subdivision (B)(4)(a)(ii) of this rule the court shall require, and with respect to discovery obtained under subdivision (B)(4)(b) of this rule the court may require, the party seeking discovery to pay the other party a fair portion of the fees and expenses reasonably incurred by the latter party in obtaining facts and opinions from the expert.

[4]Discovery orders are not final orders; therefore, they are not immediately appealable except as interlocutory orders under Rule 4(B) of the Indiana Rules of Appellate Procedure. After final judgment, discovery orders are reviewable on appeal but are frequently moot or subject to the broad discretion afforded trial courts in discovery matters. *See, e.g.*, CIGNA-INA/Aetna v. Hagerman-Shambaugh, 473 N.E.2d 1033, 1036 (Ind. Ct. App. 1985).

[5]*See infra* notes 53 and 70 and accompanying text.

[6]*American Buildings*, 506 N.E.2d at 62.

[7]*Id.* at 61.

is not based upon a proper reading of the rule's language or the policies it serves. Rule 26(B)(4) should be construed to protect the efforts of experts retained in anticipation of prior litigation in order to encourage litigants to properly prepare their cases, to discourage litigants from relying upon the pretrial efforts of their opponents and to promote the adversarial process.

II. The *American Buildings* Case

In *American Buildings Co. v. Kokomo Grain Co.*,[8] Kokomo Grain Co. ("Kokomo") brought suit against American Buildings Co. ("American") alleging breach of contract, negligence, fraud and strict liability in tort arising from the collapse of a grain storage building sold by American to Kokomo.[9] Kokomo filed a request for production of documents upon American, seeking all investigative reports and notes made by American, or on its behalf, regarding prior similar collapses of buildings sold by American, and specifically requested the report of Jim Fisher, an expert hired by American to analyze the collapse of another American building.[10]

American objected to the discovery request, asserting only that the documents sought were irrelevant and protected by the work product doctrine. Kokomo then moved for an order compelling discovery.[11] The trial court granted Kokomo's motion to compel and American appealed.[12]

On appeal, American argued that the order was erroneous as it "(1) permits discovery of work product from previously terminated litigation, (2) requires a case to have been actually filed and active at the time a document was created in order for the document to qualify as work product, and (3) limits the work product doctrine to work product of attorneys."[13] In response, Kokomo argued that the order was not in error because American did not carry its burden of demonstrating that the relevant documents were work product.[14]

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[8]506 N.E.2d 56 (Ind. Ct. App. 1987), *transfer denied*, September 14, 1987.

[9]*Id.* at 58.

[10]*Id.*

[11]*Id.*

[12]*Id.* The trial court excepted from its order compelling discovery only "those matters which are the work product of the attorneys on any and all cases that were actually filed and active at the time the information sought was determined . . . ." The court found that all other memorandums, testing results and the like are relevant to the case at bar and are discoverable as non-work product. *Id.* American brought its interlocutory appeal under Rule 4(B)(6) of the Indiana Rules of Appellate Procedure, on the trial court's certification of its order for appeal.

[13]*Id.*

[14]*Id.*

The Indiana Court of Appeals observed that while some of the documents requested by Kokomo arguably did fall under the work product doctrine, "this case also involves the requested production of a document prepared by an expert in anticipation of litigation."[15] The discovery of work product and matters from experts are governed by separate exceptions to the general rule in Rule 26(B)(1) that all relevant matters are discoverable.[16]

Consequently, the court recharacterized the issues raised by the trial court's discovery order as: (1) whether Rule 26(B)(3) applied to restrict Kokomo's discovery request for investigative reports or notices prepared by or for American in anticipation of prior litigation;[17] and (2) whether Rule 26(B)(4) applied to restrict Kokomo's request for production of the expert's report prepared in anticipation of prior litigation.[18]

A. *Rule 26(B)(3) Protects Trial Preparation Materials Prepared in Anticipation of Prior Litigation*

The court of appeals restricted the trial court's requirement that in order for materials to fall within the "in anticipation of litigation"

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[15]*Id.*

[16]*Id.* at 57-59, 62. Although the two exceptions set forth in Rules 26(B)(3) and 26(B)(4) are conceptually distinct, the inquiry under both provisions includes the threshold question of whether the matters requested are relevant to the subject matter of the litigation and not privileged. IND. R. TR. P. 26(B)(1). Rule 26(B)(1) provides:

> (1) In General. Parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject-matter involved in the pending action, whether it relates to the claim or defense of the party seeking discovery or the claim or defense of any other party, including the existence, description, nature, custody, condition, and location of any books, documents, or other tangible things and the identity and location of persons having knowledge of any discoverable matter. It is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence.

IND. R. TR. P. 26(B)(1). The court, in CIGNA-INA/Aetna v. Hagerman-Shambaugh, 473 N.E.2d 1033 (Ind. Ct. App. 1985), defined a document as relevant to discovery "if there is the possibility the information sought may be relevant to the subject matter of the action." *Id.* at 1036. There is no requirement that the requested document be relevant or admissible at trial.

The preference for discovery of all relevant material yields to the countervailing policies in favor of allowing certain information to remain non-discoverable. Examples of information that would retain such privilege include material whose production would constitute a violation of the fifth amendment privilege against self-incrimination, or would violate statutory privileges including: (i) attorney-client; (ii) minister-penitent; (iii) husband-wife; (iv) physician-patient; or (v) accountant-client. *See* IND. CODE §§ 34-1-14-5 and 25-2-1-23 (1982).

[17]506 N.E.2d at 61.

[18]506 N.E.2d at 59.

requirement of Rule 26(B)(3), a case must be filed and active.[19] The court noted that the protections afforded under the rule were based upon policies that go "to the heart of the attorney-client relationship" and that counsel would be greatly inhibited in the representation of a client if the work product protections did not extend beyond the termination of the litigation for which the documents were prepared.[20] As a result, the court held that the protections of Rule 26(B)(3) apply to items prepared in anticipation of prior litigation.[21]

The court remanded the case to the trial court in order to determine whether the trial preparation materials were discoverable.[22] The court set forth a "three-step process of shifting burdens."[23] First, the party seeking discovery must serve a request for production of documents pursuant to Rule 34.[24] The request must be reasonably particularized to inform the party of the materials that are desired. Second, the party resisting discovery must make a *prima facie* showing that the documents

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[19]*American Buildings*, 506 N.E.2d at 62. "They [courts and commentators] have made clear that a case need not be filed at the time the document is produced in order for work-product protection to attach." *Id. See also Hagerman-Shambaugh*, 473 N.E.2d at 1037. A document is found to be prepared in anticipation of litigation when "in light of the nature of the document and the factual circumstances in the particular case, the document can fairly be said to have been prepared or obtained because of the prospect of litigation." 506 N.E.2d at 62-63 (quoting 8 C. Wright & A. Miller, Federal Practice and Procedure § 2024, at 198 (1970)).

[20]*American Buildings*, 506 N.E.2d at 62.

[21]*Id.* This position is in harmony with many cases and commentary that have considered the question under Rule 26(b)(3) of the Federal Rules of Civil Procedure. *See, e.g., In re* Murphy, 560 F.2d 326, 334 (8th Cir. 1977); Duplan Corp. v. Moulinage et Retorderie de Chavonoz, 487 F.2d 480, 484 (4th Cir. 1973). *See also* Annotation, *Attorney's Work Product Privilege Under Rule 26(b)(3) of the Federal Rules of Civil Procedure as Applicable to Documents Prepared in Anticipation of Terminated Litigation*, 41 A.L.R. Fed. 123 (1979); 8 C. Wright & A. Miller, Federal Practice and Procedure § 2024, p. 199-202 (1970); Note, *The Work Product Doctrine in Subsequent Litigation*, 83 Colum. L. Rev. 412 (1983) (proposing an intermediate approach whereby trial preparation materials would receive protection from discovery when the possibility of related litigation exists).

[22]*American Buildings*, 506 N.E.2d at 65.

[23]*Id.* at 63.

[24]Rule 34 provides, in pertinent part:

(A) Scope. Any party may serve on any other party a request:

(1) to produce and permit the party making the request, or someone acting on his behalf, to inspect and copy, any designated documents (including, without limitation, writings, drawings, graphs, charts, photographs, phono-records, and other data compilations from which intelligence can be perceived, with or without the use of detection devices) or to inspect and copy, test or sample any tangible things which constitute or contain matters with the scope of Rule 26(B) and which are in the possession, custody or control of the party upon whom the request is served . . . .

Ind. R. Tr. P. 34(A)(1).

are protected as trial preparation materials under Rule 26(b)(3). This burden can be met by specifying the documents considered to be protected and the basis for protection. Third, the party seeking discovery must show substantial need of the materials and an inability to obtain the substantial equivalent without undue hardship. If the documents sought contain the mental impressions, conclusions, opinions or legal theories of an attorney or other representative of a party such documents "enjoy a near absolute immunity from discovery."[25]

B. Rule 26(B)(4) Does Not Protect the Facts Known and Opinions Held by Experts Retained in Prior Litigation

Although the court of appeals concluded that the protections afforded trial preparation materials extended to materials developed in prior litigation, the court concluded that the protections afforded the facts or opinions of experts retained in anticipation of prior litigation did not extend to subsequent litigation.[26] The report of Jim Fisher, an expert hired by American, was found to be freely discoverable under the scope of Rule 26(B)(1) and not subject to the restrictions contained in Rule 26(B)(4).[27]

The court's inconsistent application of Rules 26(B)(3) and 26(B)(4) to prior litigation arises from its definition of the phrase "in anticipation of litigation." The court recognized this inconsistency but found it "not logically possible to harmonize the meaning of 'in anticipation of litigation' within the two sections."[28] The court's compulsion to limit the scope of "in anticipation of litigation" under Rule 26(B)(4) to the instant litigation follows from the court's preoccupation with language in that provision pertaining to the different levels of discoverability between testifying and non-testifying experts.[29]

Subsections (a) and (b) of Rule 26(B)(4) provide different means of discovering an expert expected to be called as a witness at trial from an expert not expected to be called as a witness. The court found the "only logical interpretation of this subsection [Rule 26(B)(4)(b)] is that the trial in preparation of which the expert was hired, and the trial at which the expert is not expected to be called, are the one and the same

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[25]*American Buildings*, 506 N.E.2d at 63-65. *But see* Truck Ins. Exchange v. St. Paul (D.C. Pa. 1975) (an attorney's mental impressions, conclusions, opinions and legal theories were discoverable in subsequent litigation where they formed the basis for that litigation).

[26]*Id.* at 60.

[27]*Id.* at 61.

[28]*Id.* at 62.

[29]*Id.* at 60.

trial. It is impossible for an expert not to be called as a witness in a trial which has already taken place."[30]

The court's conclusion that the inquiry as to whether the expert is expected to be called as a witness at trial requires that the expert have been retained in anticipation of the *instant* litigation is greatly strained and not supported by authority. A more reasonable explanation for the inquiry as to whether the expert will testify at trial is that the rule provides for different degrees of discoverability depending upon the party's use of the expert.

The question of the application of Rule 26(b)(4) to experts retained in anticipation of prior litigation was one of first impression in Indiana and the court turned to three federal cases for authority.[31] Review of these cases shows that they provide very limited support for the court's ruling. By its terms, Rule 26(B)(4) affords protection to the facts known and opinions held by experts only when the facts or opinions have been acquired or developed in anticipation of litigation. The federal cases cited as authority by the court recognize only that the protections under Rule 26(B)(4) do not apply to: (1) facts and opinions not acquired or developed for litigation;[32] (2) facts and opinions acquired or developed

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[30]*Id.*

> [T]he protection granted materials from experts does not extend to facts known or opinions held by an expert retained or specifically employed in anticipation of prior litigation. Subsection (a) of T.R. 26(B)(4) clearly applies only to experts retained in anticipation of the pending litigation:
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> > "(a)(i) A party may through interrogatories require any other party to identify each person *whom the other party expects to call as an expert witness at trial,* to state the subject matter on which the expert is expected to testify . . . ." (Emphasis supplied).
>
> This future reference to the trial clearly limits application of this provision to experts retained for the purposes of the pending litigation. The same future reference to a trial is present in subsection (b) of the rule:
>
> > "(b) A party may discover facts known or opinions held by an expert who has been retained or specially employed by another party in anticipation of litigation or preparation for trial *and who is not expected to be called as a witness at trial* . . . ." (Emphasis supplied).
>
> The only logical interpretation of this subsection is that the trial in preparation of which the expert was hired, and the trial at which the expert is not expected to be called, are one and the same. It is impossible for an expert not to be expected to be called as a witness in a trial which has already taken place. Thus, 26(B)(4)(b) does not apply to expert witnesses retained or specifically hired in anticipation of prior litigation.

Id.

[31]*Id.* at 59-60. *See infra* notes 32-34.

[32]The court quotes Grinnell Corp. v. Hackett, 70 F.R.D. 326, 332 (D.R.I. 1976), as follows: "that discovery of experts is to be limited only insofar as the information sought was obtained for the very purpose of preparing *for the litigation in question.*"

prior to the expert being retained;[33] or (3) facts or opinions held by expert employees not specially retained.[34]

A review of the policy considerations and authorities regarding the work product doctrine, the protection of trial preparation materials under Rule 26(B)(3), and the protection of facts known and opinions held by experts under Rule 26(B)(4), leads to the conclusion that the court was correct in extending the protection granted trial preparation materials to materials prepared in anticipation of prior litigation.[35] However, the court's blanket denial of protection to facts known and opinions held by experts retained in prior litigation implicates many of the same policy concerns as are addressed in the case of trial preparation materials. A denial of protection to the work of experts in subsequent litigation may reduce the effectiveness of the adversarial process, discourage parties and their attorneys from adequately preparing their cases and allow a dilatory party to unfairly benefit from the efforts of its opponent.[36]

III. The Work Product Doctrine and Rule 26

Review of the common law development of the work product doctrine and its eventual codification in Rule 26(B)(3) shows that although the doctrine initially began as a means of protecting the labors of an attorney from discovery, the doctrine has been rapidly expanded. As now codified, the doctrine protects materials prepared in anticipation of litigation by the *party* or the party's attorney, consultant, surety, indemnitor, insurer or agent.[37] The doctrine is no longer based exclusively upon the notion of protecting an attorney's labors, although the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative receive extraordinary protection from disclosure.[38] Rule 26(B)(3)

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506 N.E.2d at 59. The above quotation is unsupported dictum as it arises in a case where the district court expressly found that the facts and opinions sought from experts were not prepared for litigation or trial. *Grinnell Corp.*, 70 F.R.D. at 333.

[33]In Sullivan v. Sturm, Ruger & Co., Inc., 80 F.R.D. 489 (D. Mont. 1978), the court did not refuse to extend the protections afforded facts known and opinions held by experts which were acquired or developed in anticipation of litigation. The court in *Sullivan* correctly permitted discovery of a party's expert as to facts known and opinions held by that expert prior to being retained in anticipation. *Id.* at 491.

[34]An expert not specifically retained or employed in anticipation does not fall within the purview of Rule 26(B)(4) and is treated as an ordinary witness. *See* Virginia Elec. & Power Co. v. Sun Shipbuilding & Dry Dock Co., 68 F.R.D. 397, 407-08 (E.D. Va. 1975).

[35]*See infra* notes 39-57 and accompanying text.

[36]*See infra* notes 58-79 and accompanying text.

[37]The court in *American Buildings* recognized this fact in further disagreeing with the trial court's interpretation of Rule 26(B)(3). 506 N.E.2d at 63. *See supra* notes 12 and 17.

[38]*See supra* note 17.

encourages litigants to undertake prudent pretrial preparation and restricts one party from unfairly benefitting from the efforts of its opposition. These same policies support the rule restricting the discovery of facts known and opinions held by experts retained in anticipation of litigation. These policies support the extension of the protections afforded under Rule 26(B)(4) to experts retained in prior litigation just as they support the court's decision to extend the protections under Rule 26(B)(3) for trial preparation materials.

A. The Work Product Doctrine and Rule 26(B)(3)

The work product doctrine has its origin in case law culminating in the landmark decision, *Hickman v. Taylor*.[39] In *Hickman*, the United States Supreme Court recognized that, although "deposition-discovery rules are to be accorded a broad and liberal treatment,"[40] a lawyer's thoughts and impressions should remain inviolate and a party should not be able to prepare its case by discovering the fruits of the efforts of its opponents.[41] The Court further recognized that proper representation of a client required that a lawyer be allowed a certain degree of privacy to discharge his duties to the client responsibly and effectively.[42]

To permit discovery of an attorney's work product,[43] the Court reasoned, would undermine the adversarial process[44] and demoralize the efforts of competent counsel.

> Inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial. The effect on the legal profession would be demoralizing. And the interests of the clients and the cause of justice would be poorly served.[45]

Nonetheless, the Court recognized that there were instances in which the protections afforded work product must succumb to other goals of

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[39]329 U.S. 495 (1947).

[40]*Id.* at 507.

[41]*Id.* at 510-12.

[42]*Id.* at 510-11.

[43]The Court defined work product of the lawyer as his "interviews, statements, memoranda, correspondence, briefs, mental impressions, personal beliefs . . . ." *Hickman*, *Id.* at 511.

[44]Justice Jackson aptly noted in his concurrence: "a common law trial is and always should be an adversary proceeding. Discovery was hardly intended to enable a learned profession to perform its functions either without wits or on wits borrowed from the adversary." *Id.* at 516 (Jackson J., concurring).

[45]*Id.* at 511.

the adversarial system including the quest for truth and discovery of facts essential to the preparation of the case.[46]

Following *Hickman*, lower courts applied the work product doctrine to protect the work product of attorney's agents[47] and the work product and information gathered by clients themselves in anticipation of litigation.[48] Indiana courts have recognized and conformed with federal decisions establishing the work product doctrine.[49]

In the federal and many state systems from 1947 through 1970, the scope and application of the work product doctrine was left to courts on a case-by-case basis.[50] Indiana adopted discovery rules on July 1, 1971, which were taken from the 1967 Proposed Amendments to the Federal Rules of Civil Procedure.[51] On January 1, 1982, Indiana's Trial Rules were amended to substantially conform to the Federal Rules of Civil Procedure.[52]

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[46]The Court stated:

> We do not mean to say that all written materials obtained or prepared by an adversary's counsel with an eye toward litigation are necessarily free from discovery in all cases. Where relevant and non-privileged facts remain hidden in an attorney's file and where production of those facts is essential to the preparation of one's case, discovery may properly be had. Such written statements and documents might, under certain circumstances, be admissible in evidence or give clues as to the existence or location of relevant facts. Or they might be useful for purposes of impeachment or corroboration. And production might be justified where the witnesses are no longer available or can be reached only with difficulty. Were production of written statements and documents to be precluded under such circumstances, the liberal ideals of the deposition-discovery portions of the Federal Rules of Civil Procedure would be stripped of much of their meaning.

Id. at 511-12.

[47]*See, e.g.*, Alltmont v. United States, 177 F.2d 971, 976 (3d Cir. 1949) (statements taken by nonlawyer protected), *cert. denied*, 339 U.S. 967 (1950). *But see* Southern Ry. Co. v. Campbell, 309 F.2d 569, 572 (5th Cir. 1962) (statements taken by nonlawyer not protected as work product).

[48]Guilford Nat'l Bank v. Southern Ry. Co., 297 F.2d 921, 926 (4th Cir. 1962).

[49]*See, e.g.*, Newton v. Yates, 170 Ind. App. 486, 353 N.E.2d 485 (1976).

[50]*See* 8 C. Wright & A. Miller, Federal Practice and Procedure § 2022, at 189-90 (1970).

[51]Ind. R. Tr. P. 26-37.

[52]See 2 W. Harvey, Indiana Practice, § 26.1 at 491-92 (1987), for a useful discussion of the development of Indiana's discovery rules and their relation to federal discovery rules. Indiana Rules 26(B)(3) and (4) are identical to their present federal counterparts. *See* Fed. R. Civ. P. 26(b)(3) and (4). Rule 26(B)(3), by its language, represents a codification of the work product doctrine as recognized in Hickman v. Taylor, 329 U.S. 195 (1947), only to the extent that discovery is sought of documents and tangible things prepared in anticipation of litigation. One commentator has correctly acknowledged that the work product doctrine has continuing vitality because it is larger than the protection afforded in Rule 26(B)(3). *See* 2 W. Harvey, *supra* § 26.8, at 503-04.

The Indiana Court of Appeals in *American Buildings*, properly determined that trial preparation materials are entitled to perpetual protection under the substantial need and undue hardship requirements of Rule 26(B)(3).[53] The court quoted extensively from *In re Murphy*[54] which recognized that the evils which the work product doctrine was designed to avoid—*i.e.*, inhibiting attorney representation of his client for fear that his files will become readily available to the adversary—would be present if work product was made available in subsequent litigation.[55]

It is interesting to note, however, that the court in *In re Murphy* relied upon the policy against inhibiting attorney representation when faced with a discovery request for production of an attorney's work product.[56] The court in *American Buildings* relied upon this very same policy without any showing that the documents sought to be discovered were the results of an attorney's efforts or part of his file.[57] The court was correct in not distinguishing between the protection afforded attorney trial preparation material and other trial preparation material as no such distinction exists under Rule 26(B)(3). The court did not, however, acknowledge the full scope of the policy considerations served by extending the protections under Rule 26(B)(3) to materials prepared in anticipation of prior litigation.

The policies served by extending the application of Rule 26(B)(3)—*i.e.*, encouraging prudent litigation preparation, prohibiting one party from benefitting from the efforts of its opponent, and preserving the adversarial process—are all present in the case of discovery of non-testifying experts retained in anticipation of prior litigation. The presence

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[53]The weight of authority supports the extension of the protections to materials prepared in anticipation of prior litigation. *See In re* Murphy, 560 F.2d 326, 334-35 (8th Cir. 1977); United States v. Leggett & Platt, Inc., 542 F.2d 655, 660 (6th Cir. 1976), *cert. denied*, 430 U.S. 945 (1977); Duplan Corp. v. Moulinage et Retorderie de Chavanoz, 509 F.2d 730, 732-33 (4th Cir. 1974), *cert. denied*, 420 U.S. 997 (1975); United States v. O.K. Tire & Rubber Co., 71 F.R.D. 465, 468 n.7 (D. Idaho 1976); SCM Corp. v. Xerox Corp., 70 F.R.D. 508, 516 (D. Conn.), *appeal dismissed*, 534 F.2d 1031 (2d Cir. 1976); Midland Investment Co. v. Van Alstyne, Noel & Co., 59 F.R.D. 134, 138 (S.D.N.Y. 1973); 4 Moore's Federal Practice ¶ 26.64[2] (2d ed. 1976); *See also* 8 C. Wright & A. Miller, Federal Practice and Procedure § 2024, at 200-01 (1970); Note, *Work Product Doctrine in Subsequent Litigation*, 83 Colum. L. Rev. 412 (1983); Note, *Discovery of an Attorney's Work Product in Subsequent Litigation*, 1974 Duke L.J. 799; Note, *Civil Procedure-Discovery-Work Product Privilege Extends to Subsequent, Unrelated Litigation*, 27 Vand. L. Rev. 826 (1974).

[54]560 F.2d 326 (8th Cir. 1977).

[55]*Murphy*, 560 F.2d at 333-34.

[56]*Id.* at 334.

[57]Kokomo sought discovery of all investigation reports and notes made by American, or on its behalf, regarding the six prior building failures. 506 N.E.2d at 58.

of these policies compel a consistent application of Rule 26(B)(3) and (4).

B. Discovery of Experts Under Rule 26(B)(4)

Prior to the promulgation of Federal Rule 26, courts took differing approaches toward discovery of experts. Case law had not established a clear distinction between testifying and non-testifying experts, and discovery was often denied on the basis of the attorney-client privilege,[58] the work product doctrine[59] or unfairness.[60] The Federal Advisory Committee Notes to the proposed amendments to the Federal Rules of Civil Procedure relating to discovery reflect a dismissal of the first two bases for protecting expert information and rely upon the emerging doctrine of unfairness as the basis for restricting discovery of experts.[61]

Under Rule 26(B)(4) experts may be divided into four classes receiving different treatment: testifying experts; non-testifying experts retained in anticipation of litigation; non-testifying experts informally consulted in preparation for trial but not retained; and experts whose information was not acquired in preparation for trial. The distinctions between these classes concern different policy considerations under Rule 26(B)(4) and therefore will be discussed separately.

1. Testifying experts.—An opponent may learn by interrogatories the names of testifying experts and the substance of their testimony; further discovery, however, can only be had on motion and court order.[62] As reflected in the Federal Advisory Committee Notes, the need for discovery of testifying experts is paramount because effective cross-

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[58]*See, e.g.*, American Oil Co. v. Pennsylvania Petroleum Prod. Co., 23 F.R.D. 680, 685-86 (D.R.I. 1959); Schuyler v. United Air Lines, Inc., 10 F.R.D. 111, 113 (M.D. Pa. 1950); Cold Metal Process Co. v. Aluminum Co., 7 F.R.D. 684, 686-87 (D. Mass. 1947). *But see* United States v. Meyer, 398 F.2d 66, 73 (9th Cir. 1968).

[59]Carpenter-Trant Drilling Co. v. Magnolia Petroleum Corp., 23 F.R.D. 257, 261 (D. Neb. 1959). *But see* United States v. McKay, 372 F.2d 174, 176-77 (5th Cir. 1967).

[60]Cases which discuss the unfairness doctrine include United States v. 2001.10 Acres of Land, 48 F.R.D. 305, 308 (N.D. Ga. 1969); Walsh v. Reynolds Metal Co., 15 F.R.D. 376, 378-79 (D.N.J. 1954). *Cf.* Maginnis v. Westinghouse Elec. Corp., 207 F. Supp. 739, 742 (E.D. La. 1962); United States v. 284,392 Square Feet of Floor Space, Etc., 203 F. Supp. 75, 77-78 (E.D.N.Y. 1962).

[61]Advisory Committee on Rules of Practices and Procedure of the Judicial Conference of the United States, Proposed Amendments to the Federal Rules of Civil Procedure Relating to Discovery (1969), *reprinted in*, 48 F.R.D. 485, 503-05 (1969) [hereinafter Federal Advisory Committee Notes]. Because Federal Rule 26(b)(4) and Indiana Rule 26(B)(4) are identical, the Federal Advisory Committee Notes are relevant to the discussion of the policies surrounding the discovery of experts in Indiana. *See supra* note 52.

[62]Ind. R. Tr. P. 26(B)(4)(a).

examination of experts at trial requires advanced knowledge of their testimony.[63]

2. Non-testifying experts retained in anticipation of litigation.—Except as provided in Rule 35,[64] providing for discovery from an examining physician, the facts known and opinions held by non-testifying experts retained in anticipation of litigation can only be discovered upon a showing of exceptional circumstances.[65]

3. Non-testifying experts informally consulted in preparation for trial but not retained.—The rule does not address these types of experts and no discovery may be had of the names or views of such persons.[66]

4. Experts whose information was not acquired in preparation for trial.—This class of experts includes both employees of a party not specifically employed for litigation and also experts who were actors or viewers of the subject matter of the litigation. All facts known and

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[63]The Federal Advisory Committee expressly adopted this policy:

> Effective cross-examination of an expert witness requires advance preparation. The lawyer even with the help of his own experts frequently cannot anticipate the particular approach his adversary's expert will take or the data on which he will base his judgment on the stand. McGlothlin, *Some Practical Problems in Proof of Economic, Scientific, and Technical Facts*, 23 F.R.D. 467, 478 (1958). A California study of discovery and pretrial in condemnation cases notes that the only substitute for discovery of experts' valuation materials is "lengthy-and often fruitless-cross-examination during trial," and recommends pretrial exchange of such material. Calif. Law Rev.Comm'n [sic], *Discovery in Eminent Domain Proceedings* 707-710 (Jan. 1963). Similarly, effective rebuttal required advance knowledge of the line of testimony of the other side. If the latter is foreclosed by a rule against discovery, then the narrowing of issues and elimination of surprise which discovery normally produces are frustrated.

FEDERAL ADVISORY COMMITTEE NOTES *supra* note 61, at 503-04.

[64]Rule 35(B) provides in pertinent part:

> (1) If requested by the party against whom an order is made under Rule 35(A) or the person examined, the party causing the examination to be made shall deliver to him a copy of a detailed written report of the examining physician setting out his findings, including results of all tests made, diagnoses and conclusions, together with like reports of all earlier examinations of the same condition. After delivery the party causing the examination shall be entitled upon request to receive from the party against whom the order is made a like report of any examination, previously or thereafter made, of the same condition, unless, in the case of a report of examination of a person not a party, the party shows that he is unable to obtain it. The court on motion may make an order against a party requiring delivery of a report on such terms as are just, and if a physician fails or refuses to make a report the court may exclude his testimony if offered at the trial.

IND. R. TR. P. 35(B).

[65]IND. R. TR. P. 26(B)(4)(b).

[66]FEDERAL ADVISORY COMMITTEE NOTES, *supra* note 61, at 504.

opinions held by such experts are freely discoverable and do not fall within the provisions of the rule.[67]

The policies which support discovery of testifying experts—*i.e.*, promoting effective cross-examination of expert witnesses, narrowing issues at trial, and eliminating surprise—do not support discovery of facts known and opinions held by non-testifying experts retained in anticipation of litigation. As the Federal Advisory Committee Notes recognized, unfairness would result when a party built its case from its opponent's experts:

> Past judicial restrictions on discovery of an adversary's expert, particularly as to his opinions, reflect the fear that one side will benefit unduly from the other's better preparation. The procedure established in [Rule 26(B)(4)(a)] holds the risk to a minimum. Discovery is limited to trial witnesses, and may be obtained only at a time when the parties know who their expert witnesses will be. A party must as a practical matter prepare his own case in advance of that time, for he could hardly hope to build his case out of his opponent's experts.[68]

Unrestricted discovery of an adversary's non-testifying expert would discourage proper trial preparation and might result in the "sharp practices" that the Supreme Court in *Hickman* sought to avoid.[69] The limited discovery permitted for testifying experts is a compromise of competing concerns whereby the adversarial process is benefitted through preparation for cross-examination and trial. No such policy concerns support the discovery of non-testifying experts retained in anticipation of trial whether in the case in which retained, or in any subsequent litigation.

The importance of restricting discovery of non-testifying experts retained in anticipation of prior litigation is particularly acute in products liability litigation. A manufacturer might retain an expert in anticipation of litigation to investigate a product and a particular incident involving that product. If the protections afforded under Rule 26(B)(4) are not extended to the facts known and opinions held by that expert in subsequent litigation, future plaintiffs might be free to build their case on the trial preparation efforts of the manufacturer.

The unfairness of this result was recognized in *In re Agent Orange Product Liability Litigation*[70] which involved complex multi-district lit-

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[67] *Id.*

[68] *Id. See also* McCarthy v. Palmer, 29 F. Supp. 585, 586 (E.D.N.Y. 1939), *aff'd* 113 F.2d 721 (2d. Cir.), *cert. denied*, 311 U.S. 680 (1940) (noting that liberal discovery of experts would be detrimental to party who had prepared in advance and would aid the party who did not retain expert).

[69] *See supra* note 45 and accompanying text.

[70] 105 F.R.D. 577 (E.D.N.Y. 1985).

igation.[71] In that case, the court found that facts acquired and opinions developed in anticipation of litigation by experts retained by the manufacturers in one of the pending actions would be protected in other pending actions under Federal Rule 26(B)(4).[72] The court found it reasonable to interpret the rule to apply to a closely related case "[g]iven the legal and factual similarities, the involvement of many of the same parties, and the procedural realities of the [multidistrict litigation] process . . . ."[73]

Legal and factual similarities are often presented in products liability cases. One way to avoid the result in *American Buildings* would be for manufacturers to simply retain experts for any and all pending *and future* litigation. This precaution has been interpreted to extend the protections of the rule to litigation subsequent to the litigation for which the expert was retained.[74]

It is possible, if not likely, that abuses may occur under Rule 26(B)(4) whereby a litigant might retain experts and label them "non-testifying" in order to insulate the experts from the reach of its adversary.[75] Such a tactic is no more likely, however, in the case where an expert has been retained for a single suit than in the case where expert is retained for all pending and future litigation and does not justify the free discovery of non-testifying experts retained in prior litigations.

Much of the abuse or hardship that may arise under the rule can be remedied upon a showing of "exceptional circumstances under which it is impractical for the party seeking discovery to obtain facts or opinions on the same subject by other means."[76] Exceptional circumstances should be found when a party retains all the experts in a specialized field or all the experts likely to be sympathetic to its opponent.[77] Further instances

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[71]*See* 28 U.S.C. § 1407(a) authorizing the Judicial Panel on Multidistrict Litigation to consolidate and transfer certain actions for purposes of pretrial efficiency and convenience.

[72]*In re* Agent Orange, 105 F.R.D. at 581. Implicit in this finding is the fact that the plaintiffs did not make "a showing of exceptional circumstances under which it is impracticable . . . to obtain facts or opinions on the same subject by other means." *Id.* at 580. The court did, in fact, allow these experts to be deposed by plaintiffs as to facts acquired and opinions developed by them that were not readily available from any other source, in addition to " 'facts known and opinions held by' them prior to their initial consultation or employment by defendants . . . ." *Id.* at 581.

[73]*Id.* at 580.

[74]*See, e.g.*, Hermsdorfer v. American Motors Corp., 96 F.R.D. 13, 15 (W.D.N.Y. 1982) (noting that the language of the rule is not inconsistent with applying the rule to protect expert information obtained for pending and future litigation).

[75]*See* Note, *A Proposed Amendment to Rule 26(b)(4)(B): The Expert Twice Retained*, 12 U. Mich. J.L. Ref. 533, 551 (1979).

[76]Ind. R. Tr. P. 26(B)(4)(b).

[77]Note, *supra* note 75 at 551 n.72.

of exceptional circumstances include where the condition of evidence has been altered and only one party's expert has viewed the evidence in its unaltered state[78] and where information is sought from the expert to prove the parties knowledge of a particular fact.[79] Reasonable use of the exceptional circumstances test can protect against abuses under Rule 26(B)(4) while protecting from discovery the pretrial efforts of litigants.

IV. Conclusion

The extension of the discovery protections afforded trial preparation materials under Rule 26(B)(3) to materials prepared in anticipation of prior litigation furthers the goals of encouraging pretrial preparation and discouraging litigants from seeking to benefit from the efforts of their adversaries. Similarly, the discovery protections afforded experts under Rule 26(B)(4) should be extended to restrict discovery of facts known and opinions held by experts retained in anticipation of prior litigation in order to serve those same goals.

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[78]Nemetz v. Aye, 63 F.R.D. 66, 68 (W.D. Pa. 1974).
[79]Roesberg v. Johns-Manville Corp., 85 F.R.D. 292 (E.D. Pa. 1980).

The "Savings" Clause of Trial Rule 60(B): Muddy Waters?

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I. Introduction

Indiana's Trial Rule 60(B) delineates the criterion under which a court may grant relief from a final judgment on motion of a party,[1]

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[1] Ind. R. Tr. P. 60(B). The rule sets out the following grounds for relief:

(1) mistake, surprise, or excusable neglect;

(2) any ground for a motion to correct error, including without limitation newly discovered evidence, which by due diligence could not have been discovered in time to move for a motion to correct errors under Rule 59;

(3) fraud (whether heretofore denominated instrinisic or extrinsic), misrepresentation, or other misconduct of an adverse party;

(4) entry of default or judgment by default was entered against such party who was served only by publication and who was without actual knowledge of the action and judgment, order or proceedings;

(5) except in the case of a divorce decree, the record fails to show that such party was represented by a guardian or other representative, and if the motion asserts and such party proves that

(a) at the time of the action he was an infant or incompetent person, and

(b) he was not in fact represented by a guardian or other representative, and

(c) the person against whom the judgment order or proceeding is being avoided procured the judgment with notice of such infancy or incompetency, and, as against a successor of such person, that such successor acquired his rights therein with notice that the judgment was procured against an infant or incompetent, and

(d) no appeal or other remedies allowed under this subdivision have been taken or made by or on behalf of the infant or incompetent person, and

(e) the motion was made within ninety [90] days after the disability was removed or a guardian was appointed over his estate, and

(f) the motion alleges a valid defense or claim;

(6) the judgment is void;

(7) the judgment has been satisfied, released, or discharged, or a prior judgment upon which it is based has been reversed or otherwise vacated, or it is no longer equitable that the judgment should have prospective application; or

(8) any reason justifying relief from the operation of the judgment, other than those reasons set forth in sub-paragraphs (1), (2), (3), and (4).

The motion shall be filed within a reasonable time for reasons (5), (6),

while also preserving a court's authority "to entertain an independent action to relieve a party from a judgment, order or proceeding or for fraud upon the court."[2] This preservation of judicial power is often referred to as Rule 60(B)'s "Savings" Clause,[3] due to a court's power to hear a party's independent action[4] claim after the time requirements of Rule 60(B)'s motion remedies have expired.[5] Although Indiana's Rule 60(B) and its federal counterpart[6] preserve the independent action, neither rule sets forth specific guidelines for the utilization of the action.[7] As

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> (7), and (8), and not more than one year after the judgment, order or proceeding was entered or taken for reasons (1), (2), (3), and (4). A motion under this subdivision (B) does not affect the finality of a judgment or suspend its operation. This rule does not limit the power of a court to entertain an independent action to relieve a party from a judgment, order or proceeding or for fraud upon the court. Writs of coram nobis, coram vobis, audita querela, and bills of review and bills in the nature of a bill of review, are abolished, and the procedure for obtaining any relief from a judgment shall be by motion as prescribed in these rules or by an independent action.

Id.

[2]*Id.*

[3]*See* 11 C. Wright & A. Miller, Federal Practice and Procedure § 2868, at 237 (1973).

[4]The term "independent action" does appear in other contexts; however, for purposes of this Article the term will have the limited meaning of those actions brought to relieve a party from a judgment, order, or proceeding or for fraud upon the court after the time limitations of Rule 60(B)'s motion procedure have run. Further, an action based on fraud upon the court is generally recognized as a separate action distinguishable from an independent action. *See* 7 J. Moore & J. Lucas, Moore's Federal Practice ¶ 60.18[8] at 60-195 to 60-197 (2d ed. 1987). For purposes of this Article, fraud upon the court will be considered as an independent action with distinctions made where relevant.

[5]Ind. R. Tr. P. 60(B). Rule 60(B) provides:

> The motion shall be filed within a reasonable time for reasons (5), (6), (7), and (8), and not more than one year after the judgment, order or proceeding was entered or taken for reasons (1), (2), (3), and (4). An independent action is subject only to the equitable doctrine of laches discussed *infra* text accompanying note 18.

[6]*See* Fed. R. Civ. P. 60(b). The Rule provides in pertinent part:

> This rule does not limit the power of a court to entertain an independent action to relieve a party from a judgment, order, or proceeding, or to grant relief to a defendant not actually personally notified as provided in Title 28, U.S.C., § 1655, or to set aside a judgment for fraud upon the court.

This provision is nearly identical to that contained in Indiana's Rule. *See supra* text accompanying note 2.

[7]The promulgators of the Federal rule provide general guidelines with respect to a party's ability to obtain relief from judgment. *See* Advisory Committee on Rules for Civil Procedure, Report of Proposed Amendments to Rules of Civil Procedure for the District Court of the United States, *reprinted at* 5 F.R.D. 433, 478-79 (1946). However, both the Indiana rule and the Federal rule are void of explicit parameters in connection with the utilization of the independent action.

a result, courts are given discretional license which, in turn, has led to inconsistent precedent.[8]

In June 1987, the Indiana Court of Appeals decided *Magnuson v. Blickenstaff*,[9] and in so doing, tackled head-on what the court described as Rule 60's "muddy waters."[10] However, in an effort to add a degree of clarity to an otherwise confused body of law, the court failed to completely address the issues presented, resulting in an opinion which generates more questions than it does answers. In order to properly analyze the court's decision in *Magnuson*, an overview of the independent action and its treatment by the United States Supreme Court is necessary.

II. Independent Action

A. Background

The origins of the independent action can be traced to England's courts of equity, which established the cause as a bill of chancery.[11] The elements of the action are perhaps best summarized by the Eighth Circuit decision *National Surety Co. of New York v. State Bank of Humboldt*,[12] rendered before the Rules of Civil Procedure were adopted:

> The indispensable elements of such a cause of action are (1) a judgment which ought not, in equity and good conscience, to be enforced; (2) a good defense to the alleged cause of action on which the judgment is founded; (3) fraud, accident, or mistake which prevented the defendant in the judgment from obtaining the benefit of his defense; (4) the absence of fault or negligence on the part of the defendant; and (5) the absence of any adequate remedy at law.[13]

In entertaining an independent action, a court does not interfere with another court's findings; rather, it acts upon the holder of a judgment in denying him the fruits thereof.[14] The most common ground

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[8]*See infra* notes 23-78 and accompanying text.

[9]508 N.E.2d 814 (Ind. Ct. App. 1987).

[10]*Id.* at 818.

[11]For a discussion of the early development of the independent action, see United States v. Throckmorton, 98 U.S. 61, 67 (1878).

[12]120 F. 593 (8th Cir. 1903).

[13]*Id.* at 599.

[14]7 J. Moore & J. Lucas, *supra* note 4, ¶ 60.36, at 60-368 (citing Johnson v. Waters, 111 U.S. 640 (1884); Arrowsmith v. Gleason, 129 U.S. 86 (1889); Chicago, R.I. & P. Ry. Co. v. Callicotte, 267 F. 799 (8th Cir. 1920), *cert. denied* 255 U.S. 570 (1921) among others).

for an independent action is fraud.[15] While Rule 60(B)(3) does provide a remedy for fraud,[16] the motion procedure is restricted by a one-year time limit,[17] which is not applicable to the independent action for fraud. Although there is no time limit as to when an independent action may be brought, Indiana follows the basic rules of equitable relief, subjecting this cause of action to the doctrine of laches and clean hands.[18]

Similar to the independent action is an action for fraud upon the court. While it encompasses the basic elements of an independent action, it is not restricted by the above-referenced equitable doctrines which limit the use of the independent action.[19] In *Hazel-Atlas Glass Co. v. Hartford Empire Co.*,[20] the United States Supreme Court explicitly stated that an action founded on fraud upon the court would not be subject to the doctrine of laches.[21] Other courts have held that a party seeking relief from judgment based on fraud upon the court is not required to come before the court with clean hands.[22]

B. The Throckmorton/Marshall/Hazel-Atlas Trilogy

One source of confusion and controversy for courts and legal commentators alike is the character of fraud which will justify relief within the context of an independent action.[23] The reason for much of this

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[15]11 C. Wright & A. Miller, *supra* note 3, § 2868, at 239 (citing Note, *Attacking Fraudulently Obtained Judgments in the Federal Courts*, 48 Iowa L. Rev. 398 (1963); Hadden v. Rumsey Prods., Inc., 196 F.2d 92 (2d Cir. 1952)).

[16]*See supra* note 2.

[17]*See supra* note 5.

[18]4 W. Harvey & R. Townsend, Indiana Practice § 60.18, at 217 (1971). *See also supra* text accompanying note 13, element four.

[19]*See infra* notes 21 - 22; *See also supra* note 4.

[20]322 U.S. 238 (1944).

[21]The Court in *Hazel-Atlas* stated:

> The Circuit Court did not hold that Hartford's fraud fell short of that which prompts equitable intervention, but thought Hazel had not exercised proper diligence in uncovering the fraud and that this should stand in the way of its obtaining relief. . . . But even if Hazel did not exercise the highest degree of diligence, Hartford's fraud cannot be condoned for that reason alone. . . . Surely it cannot be that preservation of the integrity of the judicial process must always wait upon the diligence of litigants. The public welfare demands that the agencies of public justice be not so impotent that they must always be mute and helpless victims of deception and fraud.

322 U.S. at 246.

[22]11 Wright & Miller, *supra* note 3, § 2870, at 25-1 (citing Martina Theatre Corp. v. Schine Chain Theatres, Inc., 278 F.2d 798, 801 (2d Cir. 1960)). The absence of the equitable restrictions of laches and clean hands makes the fourth element of the five indispensable elements of an independent action, *see supra* text accompanying note 13, inapplicable to actions brought based on fraud upon the court.

[23]*See infra* notes 31 and 72.

confusion and controversy can be traced to three United States Supreme Court cases in which the issue of fraud arose in connection with an independent action. In 1878, the Court, in *United States v. Throckmorton*,[24] affirmed the circuit court's dismissal of an independent action founded upon a party's use of a fraudulent document in obtaining judgment. The Court stated: "the doctrine is . . . well settled that the court *will not* set aside a judgment because it was founded on a fraudulent instrument, or perjured evidence, or for any matter which was actually presented and considered in the judgment assailed [intrinsic fraud]."[25] The Court's decision in *Throckmorton* has served as a cornerstone for all subsequent rulings and writings which make an extrinsic/intrinsic[26] fraud distinction in the utilization of an independent action.

Despite the language contained in *Throckmorton*, thirteen years later the Court in *Marshall v. Holmes*[27] stated, "it is the settled doctrine that any fact which clearly proves it to be against conscience to execute a judgment, . . . will justify an application to a court of chancery."[28] Based on the foregoing analysis, the Court in *Marshall* held that a judgment obtained by a forged instrument and false testimony *could be* enjoined in equity.[29] The *Marshall* holding, despite the Court's reference to its earlier decision in *Throckmorton*,[30] created two irreconcilable positions with respect to the class of fraud which would give rise to an independent action.[31]

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[24]98 U.S. 61 (1878).

[25]*Id.* at 66 (emphasis added). The Court also added:

> We think these decisions establish the doctrine on which we decide the present case; namely, that the acts for which a court of equity will on account of fraud set aside or annul a judgment or decree, between the same parties, rendered by a court of competent jurisdiction, have relation to frauds, extrinsic or collateral, to the matter tried by the first court, and not to a fraud in the matter on which the decree was rendered.

Id. at 68.

[26]Under *Throckmorton* and its progeny, *extrinsic* fraud is typically defined as a party's inability to present his case due to deception or trick and will serve as a basis for obtaining relief from judgment. *See* Town of Boynton v. White Const. Co., 64 F.2d 190 (5th Cir. 1933); Chicago, R.I. & P. Ry. Co. v. Callicotte, 267 F. 799 (8th Cir. 1920), *cert. denied*, 255 U.S. 570 (1921). *Intrinsic* fraud is generally defined as matters presented in reaching the judgment itself, including but not limited to, perjury and false instruments, and will not serve as a basis for obtaining relief from judgment. Wood v. McEwen, 644 F.2d 797 (9th Cir. 1981), *cert. denied*, 455 U.S. 942 (1982); Serzysko v. Chase Manhattan Bank, 461 F.2d 699 (2d Cir.), *cert. denied* 409 U.S. 883 (1972).

[27]141 U.S. 589 (1891).

[28]*Id.* at 596 (citations omitted).

[29]*Id.* at 601.

[30]*Id.* at 596.

[31]A discussion of the *Throckmorton/Marshall* conflict is included in Publicker v.

Approximately fifty years after *Marshall*, the Court was presented with an opportunity to rectify the *Throckmorton/Marshall* conflict in *Hazel-Atlas Glass Co. v. Hartford Empire Co.*,[32] a case involving a fraudulently drafted article used by Hartford Empire Company at trial in obtaining a judgment against Hazel-Atlas. However, the Court ignored the *Throckmorton/Marshall*, intrinsic/extrinsic, conflict by classifying the fraud as one committed upon the court[33] and determined that the character of fraud committed is irrelevant when it has been committed on the court.[34]

III. *Magnuson v. Blickenstaff*

A. *The Case*

Magnuson v. Blickenstaff[35] arose out of an action filed against John Magnuson and his wife by Kenneth Blickenstaff in July of 1982. The 1982 action sought recovery for services performed by Blickenstaff under a real estate listing agreement with the Magnusons. In August 1982, Blickenstaff obtained a default judgment against the Magnusons due to their failure to appear at the default hearing.[36]

After the default judgment was entered, Magnuson filed a Rule 60(B)(1) motion, claiming excusable neglect due to old age. However, in July 1984, the court denied Magnuson's motion, which ruling was not appealed.[37] On June 7, 1985, Magnuson filed a complaint against

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Shallcross, 106 F.2d 949 (3d Cir. 1939), *cert. denied*, 308 U.S. 624 (1940), where the court concluded:

> [t]he relief is, and had to be, asked for by petition on the equity side of the court. The appellant-respondent himself seems to realize this because his brief indicates his principal reliance on United States v. Throckmorton . . . .
>
> . . . .[A]ppellant's counsel seemed unaware of the existence of another later and conflicting decision in the Supreme Court, namely Marshall v. Holmes (citation omitted) That conflict has been a source of bewilderment to the "inferior" Federal Courts ever since 1891 . . . .
>
> . . . .In our judgment, and if the case arises, the harsh rule of United States v. Throckmorton . . . will be modified in accordance with the more salutary doctrine of Marshall v. Holmes, above cited. We believe truth is more important than the trouble it takes to get it.

Id. at 950-52.

[32] 322 U.S. 238 (1944).

[33] "Here, even if we consider nothing but Hartford's sworn admissions, we find a deliberately planned and carefully executed scheme to defraud not only the Patent Office but the Circuit Court of Appeals." *Id.* at 245-46.

[34] *Id.* at 246.

[35] 508 N.E.2d 814 (Ind. Ct. App. 1987).

[36] *Id.* at 816.

[37] *Id.*

Blickenstaff requesting that the previous judgment be set aside. The complaint alleged that in obtaining the August 1982 judgment, Blickenstaff "committed fraud upon the court by representing that he had procured a willing buyer [for certain real estate] when in fact the buyer had withdrawn her offer."[38] In response to Magnuson's complaint, Blickenstaff filed a Motion to Dismiss pursuant to Rule 12(B)(6).[39] The trial court granted Blickenstaff's motion "finding that the grounds which Magnuson set forth in his complaint were not shown to be unknown or unknowable to him at the time of his first motion to set aside the default judgment and therefore could not be raised in a second T.R. 60(B) motion . . . ."[40]

On appeal, the Indiana Court of Appeals affirmed the trial court's ruling, holding that Magnuson had failed to exhibit that the alleged fraud was not previously known or available to him.[41] Additionally, the court noted that Magnuson's allegations of fraud were intrinsic in nature and therefore could not support setting aside the judgment under Rule 60(B)'s savings clause. Notwithstanding the intrinsic/extrinsic distinction, the court held that Magnuson's complaint failed "to even approach the well-recognized and accepted definition of fraud on the court . . . ."[42]

B. A Rationale Questioned

In upholding the trial court's decision, the court of appeals initially addressed the trial court's reliance on *Carvey v. Indiana National Bank*.[43] In *Carvey*, the court held that a party may not file repeated Rule 60(B) motions unless there is a showing that the party bringing the motion was unaware or had no opportunity to become aware of certain facts to support the setting aside of a judgment at the time of his initial Rule 60(B) motion.[44] In *Magnuson*, the appellate court found that Magnuson's "record and his brief are devoid of *any* indication that the ground presently alleged . . . was unknown or [un]available to him" prior to the first Rule 60(B)(1) motion.[45]

However, the use of the *Carvey* precedent in the context of an independent action for fraud upon the court is inappropriate. An independent action to relieve a party from judgment is not covered under Rule 60(B)'s *motion* provision; rather, it is preserved as a separate cause

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[38]*Id.*
[39]IND. R. TR. P. 12(B)(6).
[40]508 N.E.2d at 816.
[41]*Id.* at 819.
[42]*Id.*
[43]176 Ind. App. 152, 374 N.E.2d 1173 (1978).
[44]*Id.* at 159, 374 N.E.2d at 1177.
[45]508 N.E.2d at 817.

of action. Although the court attempts to salvage the trial court's ruling by considering "Magnuson's complaint to be indistinguishable from a [Rule] 60(B) motion,"[46] such a position is contrary to a plain reading of Rule 60.[47] Further, Magnuson's failure to plead that he was incapable of discovering the alleged fraud at the time of his Rule 60(B)(1) motion has no bearing on an action based on fraud upon the court because the doctrine of laches is not applicable to such an action.[48]

Perhaps sensing the trial court's misplaced reliance on *Carvey*, the court of appeals proceeded to address the true merits of the case: Magnuson's right to bring an independent action for fraud upon the court based on the alleged fraudulent representations of Blickenstaff. The court recognized that a party may bring an independent action for fraud upon the court independent of Rule 60(B)'s motion provisions,[49] however, the court noted that "no Indiana cases provide . . . a precise definition of fraud upon the court. . . ."[50] In an effort to develop a definition, the court turned to *Chermak v. Chermak*,[51] a case which held, like *Throckmorton*,[52] that allegations of intrinsic fraud (i.e. perjury) can not support the setting aside of a judgment.[53] Relying upon *Chermak*, as well as recent federal decisions[54] and commentary,[55] the *Magnuson*

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[46]*Id.* at 816.

[47]Oddly enough, the court, in footnote 2 of its opinion, stated:

> Magnuson cites us to T.R. 60(B)(8) as allowing an independent action for fraud upon the court. However, the provision allowing an action for fraud upon the court is actually not a subsection of T.R. 60(B), but rather a provision added in the paragraph following the subsections of T.R. 60(B).

Id. at 817 n.2. One authority, relied on throughout the court's opinion, states that a court, by entertaining an independent action, does not interfere with another court's findings. Rather, it acts upon the holder of a judgment in denying him the fruits thereof. 7 J. Moore & J. Lucas, *supra* note 4, ¶ 60.36, at 60-368 (citations omitted).

[48]The language in *Carvey*, with respect to a party's lack of information or inability to obtain information, parallels the language contained in *Hazel-Atlas*, where the Supreme Court stated that a party's diligence, or lack thereof, would not preclude an action based on fraud upon the court. *See supra* note 21 and accompanying text.

[49]508 N.E.2d at 817 (citing Caley v. Lung, 257 Ind. 116, 271 N.E.2d 891 (1971); Ayres v. Smith, 227 Ind. 82, 84 N.E.2d 185 (1949); Smith v. Tisdal, 484 N.E.2d 42 (Ind. Ct. App. 1985); and Anderson v. Anderson, 399 N.E.2d 391 (Ind. Ct. App. 1979).

[50]*Magnuson*, 508 N.E.2d at 818.

[51]227 Ind. 625, 88 N.E.2d 250 (1949).

[52]*See supra* notes 24-26 and accompanying text.

[53]*Chermak*, 227 Ind. at 627, 88 N.E.2d at 251.

[54]508 N.E.2d at 818 (citing, among others, Great Coastal Express, Inc. v. Int'l. Bhd. of Teamsters, 675 F.2d 1349 (4th Cir. 1982), *cert. denied*, 459 U.S. 1128 (1983); Wood v. McEwen, 644 F.2d 797 (9th Cir. 1981), *cert. denied*, 455 U.S. 942 (1982); and Serzysko v. Chase Manhattan Bank, 461 F.2d 699 (2d Cir.), *cert. denied*, 409 U.S. 883 (1972)).

[55]"The commentators caution that an independent action for fraud on the court only includes allegations of *extrinsic* fraud." 508 N.E.2d at 818 (citing 4 W. Harvey & R. Townsend, *supra* note 18, § 60.18; 7 J. Moore & J. Lucas, *supra* note 4, ¶¶ 60.33, 60.37[1]).

court concluded that perjury or false evidence "whether denominated intrinsic or extrinsic or neither, is not an accepted ground on which to receive relief from judgment."[56]

The court's finding is subject to question on several grounds. First, by determining that Indiana case law does not provide a "precise" definition of fraud upon the court, the *Magnuson* court overlooks *Caley v. Lung*,[57] decided by the Indiana Supreme Court twenty-two years after *Chermak*. In *Caley*, the plaintiff, Lung, filed an independent action to set aside an adoption on the grounds that there were *fraudulent statements in the adoption petition* filed by the Caleys, as well as fraudulent statements made to Lung in obtaining her consent to the adoption.[58] The Caleys filed a motion to dismiss Lung's independent action, stating that Rule 60(B)'s one-year time limitation precluded Lung from initiating such an action. When the Caleys' motion to dismiss was denied, they appealed.[59]

The Indiana Supreme Court determined that the Caleys' appeal could not be addressed because the denial of a motion to dismiss is not an appealable order.[60] However, the court also determined that the appeal presented an important question that, if resolved at that time, might avoid an appeal at a later time.[61] Therefore, the court concluded that the action which Lung brought "clearly allege[d] that the judgment was procured through fraud upon the court" and should be considered as an independent action.[62]

Second, not only did the court overlook *Caley*, it also failed to address the United States Supreme Court cases of *Hazel-Atlas Glass Co. v. Hartford Empire Co.*[63] and *Marshall v. Holmes*[64] which held that perjury or false evidence *is* an accepted ground on which to receive relief from judgment. Although the court did rely on *United States v. Throckmorton*,[65] that case, unlike *Hazel-Atlas*, was not an action for fraud upon the court. While it is possible to distinguish *Hazel-Atlas* and

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[56]508 N.E.2d at 817.

[57]257 Ind. 116, 271 N.E.2d 891 (1971). Although the *Magnuson* court cites four Indiana decisions, including *Caley*, which discuss fraud upon the court, 508 N.E.2d at 817, it does not review any of the cases. Interestingly, the two court of appeals decisions cited in *Magnuson* refer to *Caley*. *See* Smith v. Tisdal, 484 N.E.2d 42, 44 n.2 (1985); Anderson v. Anderson, 399 N.E.2d 391, 400 n.17 (1979).

[58]*Caley*, 257 Ind. at 117, 271 N.E.2d at 891.

[59]*Id.*

[60]*Id.* at 118, 271 N.E.2d at 892.

[61]*Id.*

[62]*Id.* at 119, 271 N.E.2d at 893.

[63]322 U.S. 238 (1944).

[64]141 U.S. 509 (1891).

[65]98 U.S. 61 (1878).

Marshall from *Magnuson*, the court's failure to even consider these decisions makes such an attempt highly subjective.[66]

Finally, the court, in an effort to bolster its holding, asserts that "[t]he commentators (citing *Harvey* and *Moore*) caution that an independent action for fraud on the court only includes allegations of *extrinsic* fraud."[67] Such a statement is, at best, misleading. While *Moore*[68] may lend some support to the court's position, *Harvey*,[69] does not. *Harvey* commented that "*[s]o-called* intrinsic fraud, *not clearly defined by precedents*, will not support independent relief"[70] and that the intrinsic/extrinsic distinction is one without merit.[71] The court's assertion clearly runs contrary to the concerns expressed by *Harvey*. Additionally, a review of *Wright & Miller*[72] and the Advisory Committee Notes to Federal

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[66]It might be that the *Magnuson* court believed the various federal cases cited in support of its holding adequately addressed the *Throckmorton/Marshall/Hazel-Atlas* conflict. However, a review of several of these federal decisions evidences that the federal courts have no better handle on the operation of the "Savings" Clause than the *Magnuson* court. In Bulloch v. United States, 763 F.2d 1115 (10th Cir. 1985), *cert. denied*, 474 U.S. 1086 (1986) one of the more recent cases cited by the *Magnuson* court in support of its position, the dissent finds that although the majority points to *Hazel-Atlas* as authority for the proposition that fraudulent documents cannot constitute fraud upon the court, it [the majority] "ignores the fact that the *Hazel-Atlas* Court found precisely the opposite - that fraudulent documents . . . can constitute such fraud." *Id.* at 1126 (McKay, J., dissenting). Additionally, in Great Coastal Express, Inc. v. Int'l Bhd. of Teamsters, 675 F.2d 1349 (4th Cir. 1982), *cert. denied*, 459 U.S. 1128 (1983), also cited by the court, the dissent objected to the majority's limited application of fraud upon the court by stating:

> Commentators have suggested that involvement of an attorney is an essential component of fraud on the court when misconduct of other officers of the court is not established. . . . The Supreme Court, however, neither predicated its decision in *Hazel-Atlas* on the narrow ground of an attorney's involvement in the litigant's fraud, nor did it identify this as an element of fraud on the court.

Id. at 1363 (Butzner, J., dissenting).

[67]*Magnuson*, 508 N.E.2d at 818.

[68]7 J. Moore & J. Lucas, *supra* note 4, ¶¶ 60.33, 60.37[1].

[69]4 W. Harvey & R. Townsend, *supra* note 18, § 60.18.

[70]*Id.* at § 60.18 (emphasis added).

[71]*Id.* at § 60.12. Strangely enough the *Magnuson* court recognized *Harvey*'s criticism of the extrinsic/intrinsic distinction, but went on to cite the commentator in support of its holding. 508 N.E.2d at 818.

[72]These commentators state:

> However, Rule 60(b)(3) goes to all fraud, "whether heretofore denominated intrinsic or extrinsic" while no such statement is made in the rule concerning the independent action. Accordingly there is some authority that the old distinction persists if relief is sought by an independent action, rather than by motion, and that the action will lie for "extrinsic" fraud but not for "intrinsic" fraud. This is most unfortunate, if true. The distinction rests on clouded and confused

Rule 60(b)[73] finds that these "commentators" do not support the court's intrinsic/extrinsic policy with respect to an independent action based on fraud upon the court.

The court concluded its opinion by noting that "notwithstanding the intrinsic-extrinsic [fraud] distinction," Magnuson's complaint failed to approach the well-recognized and accepted definition of fraud upon the court[74] which the court set forth as follows:

> "Fraud upon the court" should, we believe, embrace only that species of fraud which does or attempts to, subvert the integrity of the court itself, *or* is a fraud perpetrated by officers of the court so that the judicial machinery cannot perform in the usual manner its impartial task of adjudging cases that are presented for adjudication . . . .[75]

As referred to earlier, Magnuson's complaint included the claim that Blickenstaff had fraudulently represented to the court that he had obtained a willing buyer, when in fact the buyer had withdrawn her offer.[76] If Magnuson's allegations were true, did Blickenstaff attempt to "subvert the integrity of the court" by misleading the court into believing he had a willing purchaser? Apparently, the court of appeals did not think so. However, in what manner should the court's definition be applied in future cases, and what permits cases such as *Caley* and *Hazel-Atlas* to fall within the court's definition? The court's attempt at formulating a concise definition of fraud upon the court lends credibility to the Ninth Circuit's conclusion in *Toscano v. Commissioner*[77] that most efforts to define fraud upon the court are "merely compilations of words that do not clarify."[78]

IV. Conclusion

In upholding the trial court's finding that Magnuson's complaint failed to state a claim upon which relief could be granted, the Indiana

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authorities, its soundness as a matter of policy is very doubtful and it is extremely difficult to apply (footnotes omitted).

11 C. Wright & A. Miller, *supra* note 3, § 2868, at 240.

[73]*See* Advisory Committee on Rules for Civil Procedure, Report of Proposed Amendments to Rules of Civil Procedure for the District Courts of the United States, *reprinted at* 5 F.R.D. 433, 479 (1946).

[74]508 N.E.2d at 819.

[75]*Id.* (citing, 7 J. Moore & J. Lucas, *supra* note 4, ¶ 60.33 at 60-360 (emphasis added)).

[76]*Magnuson*, 508 N.E.2d at 817.

[77]441 F.2d 930 (9th Cir. 1971).

[78]*Id.* at 433.

Court of Appeals has fashioned a hard-and-fast rule that alleged perjury or false evidence is not an accepted ground for receiving relief from judgment under Rule 60(B)'s "Savings" Clause. However, in reaching its decision, the court failed to consider and distinguish two United States Supreme Court decisions and an Indiana Supreme Court ruling which hold that perjury or false evidence can serve as a basis for relieving a party from judgment. The Court of Appeals has left unanswered numerous questions with respect to Indiana's independent action, and until those questions are answered, the waters surrounding Trial Rule 60(B)'s "Savings" Clause will remain muddied.

White v. State: And Now for Something Different

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Richard Pitts**

I. Introduction

On September 10, 1986, one could almost hear a collective sigh of despair arise from the ranks of criminal defense counsel and public defenders in the state of Indiana. On that day, the Indiana Supreme Court handed down *White v. State*,[1] an opinion that addresses the question of what standard should be employed in adjudging a defendant's petition for post-conviction relief alleging that his guilty plea was not made voluntarily, intelligently and knowingly. Although cases addressing this question are too numerous to mention, *White* differed from many of the others because, once again, the supreme court changed the standard. The *White* case became the fifth such change in less than ten years. The first change occurred in *Neeley v. State*[2] in 1978, followed by *German v. State*[3] in 1981. The Indiana General Assembly then made an addition to the guilty plea statute in 1984.[4] The fourth change occurred in *Austin v. State*,[5] a supreme court opinion attempting to offset the statutory addition. This lack of consistency in the area of post-conviction relief can only lead to an increasingly frustrated criminal bar, particularly because the ramifications of *White* are very problematic given the current uncertain application of the law as well as the loose ends created by the case itself.

This Article will, after a brief exposition of pre-*White* post-conviction relief under Indiana law, analyze *White v. State* as it stands alone and will attempt to unravel some of the issues raised by its holding and retroactive application. Because of the shifting and varied considerations of any single fact situation, the conclusions drawn here are necessarily

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[1] 497 N.E.2d 893 (Ind. 1986).

[2] 269 Ind. 588, 382 N.E.2d 714 (1978).

[3] 428 N.E.2d 234 (Ind. 1981).

[4] *See infra* note 28 and accompanying text.

[5] 468 N.E.2d 1027 (Ind. 1984). *See infra* notes 79-84 and accompanying text.

broad. Indeed, research reveals that there simply is no definitive rule of law in the *White* situation. Consequently, this Article can do nothing more than attempt to shed light on a limited number of discrete issues defense counsel may wish to consider in their guilty plea practice.

II. Background of Post-Conviction Relief in Indiana

The genesis of state post-conviction relief is found in three United States Supreme Court cases. In *Mooney v. Holohan*,[6] the Supreme Court held only that the habeas corpus procedures of California were, standing alone, apparently sufficient to meet the minimum requirements of due process in giving post-conviction litigants some forum in which to vindicate their claims.[7] Probably because of this less than forceful pronouncement, the status of state post-conviction relief remained relatively unchanged until *Young v. Ragen*.[8] In *Young*, the Court pointed out that states are obligated, under the Fourteenth Amendment's due process clause, to give those convicted in state court a clearly defined method by which claims alleging denial of a federal constitutional right could be litigated.[9]

In 1965, the Court was poised to confront squarely the question of whether the lack of a post-conviction remedy was itself a denial of due process. The case was set against the backdrop of an increase in the number of federal habeas corpus actions. After certiorari was granted in *Case v. Nebraska*,[10] the Nebraska legislature enacted a statewide post-conviction procedure. As a result, the Court in *Case* simply vacated the judgment and remanded for reconsideration under the new Nebraska statute.[11] Of particular note is Justice Brennan's concurring opinion, in which he delineated some of the characteristics of an appropriate state post-conviction procedure. Justice Brennan wrote:

> The procedure should be swift and simple and easily invoked. It should be sufficiently comprehensive to embrace all federal constitutional claims. . . . [I]t should eschew rigid and technical doctrines of forfeiture, waiver or default. It should provide for full fact hearings to resolve disputed factual issues, and for compilation of a record to enable federal courts to determine the sufficiency of those hearings. It should provide for decisions supported by opinions, or fact findings and conclusions of law,

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[6]294 U.S. 103 (1935).
[7]*Id.* at 113.
[8]337 U.S. 235 (1949).
[9]*Id.* at 239.
[10]177 Neb. 404, 129 N.W.2d 107, *cert. granted* 379 U.S. 958 (1965).
[11]Case v. Nebraska, 381 U.S. 336, 337 (1965).

> which disclose the grounds of decision and the resolution of disputed facts. Provision for counsel to represent prisoners . . . would enhance the probability of effective presentation and proper disposition of prisoners' claims.[12]

Similar themes have been sounded by the American Bar Association[13] and the National Conference of Commissioners on Uniform State Laws.[14] The National Conference of Commissioners on Uniform State Laws, in its prefatory notes to the Uniform Post-Conviction Procedure Act, listed the following goals of the act:

> 1. A simple and expeditious procedure;
> 2. A single procedure obviating the need for state habeas corpus or coram nobis proceedings;
> 3. Disposition on the merits of the claims whenever possible;
> 4. Elimination of subsequent post-conviction petitions by the same petitioner concerning the same conviction.[15]

In large measure, the Indiana Rules of Post-Conviction Relief are designed to effectuate the same goals.[16]

Post-conviction relief in Indiana has developed considerably over the last 100 years. During the nineteenth century, courts operated under the premise that a prisoner's word was sufficient to establish guilt.[17] Courts later began to evolve devices for making certain that pleas were not induced by threat or coercion but by voluntary and intelligent choice.[18] In order to process guilty pleas more systematically, the Indiana General

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[12]*Id.* at 346-47 (Brennan, J., concurring) (citations omitted). Justice Brennan also noted that the Nebraska statute was, "plainly an adequate corrective process." *Id.*

[13]*See* American Bar Association, *Standards Relating to Post-Conviction Remedies*, § 4.5 (1967 tentative draft and commentary; American Bar Association, *Standards Relating to Pleas of Guilty* (1967 tentative draft).

[14]*See* Unif. Post-Conviction Procedure Act § 1 comment, 11 U.L.A. 233, 234 (1980).

[15]Unif. Post Conviction Procedure Act, Commissioners' Prefatory Note, 11 U.L.A. 477, 479-80 (1966), Commissioners' Prefatory Note.

[16]*See* Ind. R. P. Post-Conviction Remedies 1 § 1(b) (as to unitary remedy); and § 8 (as to single proceeding arising from conviction).

[17]Griffith v. State, 36 Ind. 406, 408 (1871).

[18]White v. State, 497 N.E.2d 893, 895 (Ind. 1986). *See, e.g.*, Crooks v. State, 214 Ind. 505, 15 N.E.2d 359 (1938); Myers v. State, 115 Ind. 554, 18 N.E. 42 (1888). Although the *White* opinion does not elaborate on these developments to protect a defendant, they include the requirement that the guilty plea be transcribed, that the defendant be informed of the ramifications of his guilty plea, and that a route be provided for withdrawing a plea on collateral attack. *See* Ind. R. Crim. P. 10; State v. Lindsey, 231 Ind. 125, 106 N.E.2d 230 (1952).

Assembly enacted Indiana Code section 35-4.1-1-3,[19] setting forth the advisements a trial court must make to the pleading defendant, and Indiana Code section 35-4.1-1-4,[20] specifying the findings a trial court must make in order to establish that a defendant has properly entered his plea.[21]

The first opinion interpreting the requirements set forth in these statutory provisions was *Neeley v. State*.[22] In *Neeley*, the supreme court found the record established that the defendant actually knew about the rights he was waiving. Consequently, the court concluded that even though the trial judge did not follow the statutory requirements to the letter, the defendant, as a result of his knowledge, was not entitled to post-conviction relief.[23]

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[19]Section 3 provided:

> The court shall not accept a plea of guilty from the defendant without first addressing the defendant and
> (a) determining that he understands the nature of the charge against him;
> (b) informing him that by his plea of guilty he is admitting the truth of all facts alleged in the indictment or information or to an offense included thereunder and that upon entry of such plea the court shall proceed with judgment and sentence;
> (c) informing him that by his plea of guilty he waives his rights to a public and speedy trial by jury, to face the witnesses against him, to have compulsory process for obtaining witnesses in his favor and to require the state to prove his guilt beyond a reasonable doubt at a trial at which the defendant may not be compelled to testify against himself;
> (d) informing him of the maximum possible sentence and minimum sentence for the offense charged and of any possible increased sentence by reason of the fact of a prior conviction or convictions, and of any possibility of the imposition of consecutive sentences;
> (e) informing him that the court is not a party to any agreement which may have been made between the prosecutor and the defense and is not bound thereby.

Ind. Code § 35-4.1-1-3 (repealed 1981).

[20]Section 4 provided:

> (a) The court shall not accept a plea of guilty without first personally addressing the defendant and determining that the plea is voluntary. The court shall address the defendant and determine whether any promises, force or threats were used to obtain the plea.
> (b) The court shall not enter judgment upon a plea of guilty unless it is satisfied from its examination of the defendant that there is a factual basis for the plea.
> (c) A plea of guilty shall not be deemed to be involuntary under subsection (a) of this section solely because it is the product of an agreement between the prosecution and the defense.

Ind. Code § 35-4.1-1-4 (repealed 1981).

[21]Act of Apr. 23, 1973, Pub. L. No. 325, § 4, 1973 Ind. Acts 1750, 1789-90. Perhaps, not coincidentally, these statutory provisions were enacted shortly after the bedrock guilty plea case of Boykin v. Alabama, 395 U.S. 238 (1969).

[22]269 Ind. 588, 382 N.E.2d 714 (1978).

[23]*Id.* at 595-96, 382 N.E.2d at 718.

In 1981, the Indiana Supreme Court overruled *Neeley* in *German v. State*,[24] stating that "it is the duty of the trial judge to comply strictly with the terms of IND. CODE § 35-4.1-1-3 . . . ."[25] The court ultimately held that the failure of the trial judge to "[a]ddress the defendant according to the requirements and determine that the defendant understands the charges against him" required that the guilty pleas be vacated and the matter be tried.[26]

In response to the strict requirement set forth in *German*, the Indiana General Assembly added the following language to Indiana Code section 35-35-1-2:[27] (c) Any variance from the requirements of this section that does not violate a constitutional right of the defendant is not a basis for setting aside a plea of guilty.[28]

Such a change "cut at the heart of the *German* decision, which had described the judge's obligation to advise defendants as 'statutory.'"[29] In answer to the legislature's action, the supreme court, in *Austin v. State*,[30] declared the "harmless error" provision set forth in Indiana Code section 35-35-1-2(c) a nullity on the premise the advisements set forth in subsection 35-35-1-2(a)[31] are of constitutional dimen-

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[24]428 N.E.2d 234 (Ind. 1981).

[25]*Id.* at 236.

[26]*Id.* at 236-37.

[27]In 1981, the legislature repealed sections 35-4.1-1-3 and 35-4.1-1-4 and replaced them with sections 35-35-1-3 and 35-35-1-2 respectively. Act of May 5, 1981, Pub. L. No. 298, §§ 4, 9, 1981 Ind. Acts 2314, 2366-67, 2391.

[28]Act of Feb. 29, 1984, Pub. L. No. 179, § 1, 1984 Ind. Acts 1486, 1487 (codified at IND. CODE § 35-35-1-2(c) (Supp. 1987)).

[29]White v. State, 497 N.E.2d 893, 896 (Ind. 1986) (citing German v. State, 428 N.E.2d 234, 237 (Ind. 1981)).

[30]468 N.E.2d 1027 (Ind. 1984).

[31]This section provides:

> (a) The court shall not accept a plea of guilty or guilty but mentally ill at the time of the crime without first determining that the defendant:
> (1) understands the nature of the charge against him;
> (2) has been informed that by his plea he waives his rights to:
> (A) a public and speedy trial by jury;
> (B) confront and cross-examine the witnesses against him;
> (C) have compulsory process for obtaining witnesses in his favor; and
> (D) require the state to prove his guilt beyond a reasonable doubt at a trial at which the defendant may not be compelled to testify against himself;
> (3) has been informed of the maximum possible sentence and minimum sentence for the crime charged and any possible increased sentence by reason of the fact of a prior conviction or convictions, and any possibility of the imposition of consecutive sentences; and
> (4) has been informed that if:
> (A) there is a plea agreement as defined by IC 35-35-3-1; and
> (B) the court accepts the plea;
> the court is bound by the term of the plea agreement.

IND. CODE § 35-35-1-2(a) (Supp. 1987).

sion.[32] This ruling set the stage for the *White* court's divergence from prior law in its interpretation of the statute and of the standard by which a trial court's advisements are to be measured.

III. *White v. State*, The Case

Randy White pleaded guilty, in September 1981, to charges of burglary and theft and received consecutive sentences of ten and two years, respectively.[33] Two years later, White filed a petition for post-conviction relief seeking to set his plea aside on the ground that the trial court failed to advise him of the possible minimum sentences applicable to each charge if he had elected to go to trial rather than to plead guilty.[34] He claimed the absence of this advisement rendered his plea involuntary, unintelligent, and unknowing.[35] The trial court denied the petition, and White appealed. In an unpublished memorandum opinion,[36] the Indiana Court of Appeals agreed with White and reversed the trial court, thereby giving him the opportunity to withdraw his plea.[37] After the denial of its rehearing petition,[38] the State sought transfer to the supreme court, evidently to curb a rising tide of identical post-conviction relief petitions presenting the same fatal flaw.[39] This time, the State succeeded.

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[32]The *Austin* court stated:

> An accused's entitlement to such advisements, therefore, flows from his due process right to be sheltered from the consequences of a guilty plea entered on less than an informed judgment and not from the legislative inclusion of it in its codification. The legislature may, as a matter of public policy, require advisements that are not of such dimension, but it could not eliminate the requirements of those essential to an informed judgment, which includes the one omitted by the court that accepted the guilty plea.

468 N.E.2d at 1028.

[33]*White*, 497 N.E.2d at 894.

[34]*Id.* Post-conviction relief is afforded defendants under Rule 1 of the Indiana Rules of Procedure for Post-Conviction Remedies.

[35]497 N.E.2d at 894. In a footnote, the supreme court intimates it may as well abandon the "knowingly" element for measuring the validity of a guilty plea. *Id.* n.1. There is a question as to the wisdom of this statement in the face of constitutional considerations. *See* Johnson v. Zerbst, 304 U.S. 458 (1938). Inasmuch as this statement is mere dictum, this Article will continue to adhere to the tripartite terminology. *See also* Ind. Code § 35-35-1-4(c)(3) (Supp. 1987).

[36]White v. State, 465 N.E.2d 228 (Ind. Ct. App. 1984).

[37]White v. State, 465 N.E.2d 228 (Ind. Ct. App. 1984), *reh. denied*, 484 N.E.2d 82 (Ind. Ct. App. 1985).

[38]484 N.E.2d at 82.

[39]*E.g.*, Jones v. State, 478 N.E.2d 676 (Ind. 1985); Williams v. State, 468 N.E.2d 1036 (Ind. 1984); Austin v. State, 468 N.E.2d 1027 (Ind. 1984).

The supreme court, comprised of new members since the earlier cases involving the same problem,[40] invoked a new standard for reviewing guilty pleas:

> A petitioner who claims that his plea was involuntary and unintelligent but can only establish that the trial judge failed to give an advisement in accordance with § 35-35-1-2 has not met his burden of proof. He needs to plead specific facts from which a finder of fact could conclude by a preponderance of the evidence that the trial judge's failure to make a full inquiry in accordance with § 35-35-1-2(a) rendered his decision involuntary or unintelligent. Of course, unless the record reveals that the defendant knew or was advised at the time of his plea that he was waiving his right to a jury trial, his right of confrontation and his right against self-incrimination, *Boykin*[41] will require that his conviction be vacated.[42]

When compared to the standards assumed and discarded through the years, *White*'s pronouncement obviously instituted a radical change in the method of reviewing a guilty plea on collateral attack. The major questions raised by this change are, how and why did the court arrive at this new standard?

First, the *White* court declared that most of the statutory advisements in Indiana Code section 35-35-1-2 lack constitutional foundation, citing *Boykin v. Alabama*.[43] This statement is contrary to the *Austin* declaration.[44] The court explains that *Boykin* identified only three rights of which a defendant need be advised as mandated by the United States Constitution—"the right to a trial by jury, the right to confront one's accusers, and the right against self-incrimination."[45] From this statement, the *White* court concluded that the other advisements in Indiana Code section 35-35-1-2 are thus not guaranteed by the United States Constitution. By further extrapolation, the opinion also concluded that they did not derive from the Indiana Constitution, particularly because the words "due process" appear nowhere in it.[46] The court then engaged

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[40]Justices Shepard and Dickson joined the court in 1985 and 1986, respectively, replacing Justices Hunter and Prentice who voted in the majority in Jones v. State, 478 N.E.2d 676 (Ind. 1985); Williams v. State, 468 N.E.2d 1036 (Ind. 1984); and Austin v. State, 468 N.E.2d 1027 (Ind. 1984).

[41]Boykin v. Alabama, 395 U.S. 238 (1969).

[42]*White*, 497 N.E.2d at 905.

[43]395 U.S. 238 (1969).

[44]497 N.E.2d at 897.

[45]*Id.*

[46]*Id.*

in a circuitous discussion refuting the rationale of *Austin v. State*, done apparently in order to undermine the *Austin* court's declaration that the *German* standard of strict adherence to the statutory procedure is undisputedly a province of the courts alone because of its constitutional dimensions and is therefore outside the realm of the legislature's "harmless error" codification.[47] Having thereby "weakened" the *German* standard, the *White* court continued in this vein to what appears to be the true purpose of the opinion—a criticism of the application of the strict *German-Austin* review.

The court acknowledged the ease with which *German* can be applied by "being easy to remember and easy to apply."[48] The court then set forth the disadvantages to its application: common sense dictates that some of the trial court's omissions are harmless, and post-conviction relief proceedings are being abused by defendants who are exercising their rights on the basis of these picayune errors.[49] In search of an alternative to the *German* "prophylactic" rule, the supreme court turned to the federal courts for guidance for a more appropriate standard.

The *White* opinion noted the fundamental inquiries federal courts have made into the voluntary, knowing and intelligent basis for a defendant's plea. For example, the Seventh Circuit Court of Appeals, in *United States v. Wetterlin*,[50] looked to the totality of the circumstances surrounding the plea to determine whether the defendant understood his rights.[51] This issue was framed in *Hill v. United States*[52] as, "Was the error in the proceeding a fundamental defect which inherently results in a complete miscarriage of justice or an omission inconsistent with the rudimentary demands of fair procedure?"[53] The *White* opinion makes clear that these formulations of the fundamental issue arose in a context similar to that of *German* and *Austin*—the impact of a "statutory" list of advisements.

In the federal courts, however, this list of advisements takes the form of Rule 11 of the Federal Rules of Criminal Procedure.[54] Starting

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[47]*Id.* at 897-900. *See Austin*, 468 N.E.2d at 1028-29. *See also supra* notes 27-32 and accompanying text.

[48]White, 497 N.E.2d at 900.

[49]*Id.*

[50]583 F.2d 346, 354 (7th Cir. 1978), *cert. denied*, 439 U.S. 1127 (1979).

[51]497 N.E.2d at 902.

[52]368 U.S. 424 (1962).

[53]*White*, 497 N.E.2d at 902 (citing *Hill*, 368 U.S. 424 (1962).

[54]Fed. R. Crim. P. 11. Rule 11 (c) provides:

(c) Advice to the Defendant. Before accepting a plea of guilty or nolo contendere, the court must address the defendant personally in open court and inform him of, and determine that he understands, the following:

(1) the nature of the charge to which the plea is offered, the mandatory

with *McCarthy v. United States*,[55] in which the United States Supreme Court declared that a failure to comply with an early version of Rule 11 mandated vacation of a plea on direct appeal, the federal circuit courts eventually reached a *German*-like conclusion that, under an amended version of Rule 11, any violation of the rule was per se prejudicial even on collateral attack.[56] However, the Supreme Court, in *United States v. Timmreck*,[57] wholeheartedly rejected that conclusion where the trial court had failed to inform a defendant of a mandatory special parole term. The Court declared that where, as in *Timmreck*, the trial court has committed only a violation of Rule 11's "formal" requirements, collateral relief from a guilty plea was not available.[58] In the context of *Timmreck*'s holding, the *White* court cites to various situations where other federal courts have come to similar conclusions, by requiring a defendant to show prejudice,[59] by declaring that reality rather than ritual must govern review,[60] or by finding the lack of a certain advisement is harmless error.[61] Rounding out its discussion and reaching its ultimate conclusion, as set forth previously, the *White* opinion quoted from a recent case from the Supreme Court, *United States v. Mechanik*,[62] which denounced

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> minimum penalty provided by law, if any, and the maximum possible penalty provided by law, including the effect of any special parole term and, when applicable, that the court may also order the defendant to make restitution to any victim of the offense; and
> (2) if the defendant is not represented by an attorney, that he has the right to be represented by an attorney at every stage of the proceeding against him and if necessary, one will be appointed to represent him; and
> (3) that he had the right to plead not guilty or to persist in that plea if it has already been made, and he has the right to be tried by a jury and at that trial has the right to the assistance of counsel, the right to confront and cross-examine witnesses against him, and the right not to be compelled to incriminate himself; and
> (4) that if his plea of guilty or nolo contendere is accepted by the court there will not be a further trial of any kind, so that by pleading guilty or nolo contendere he waives the right to a trial; and
> (5) if the court intends to question the defendant under oath, on the record, and in the presence of counsel about the offense to which he has pleaded, that his answers may later be used against him in a prosecution for perjury or false statement.

[55] 394 U.S. 459 (1969).

[56] *See, e.g.*, Timmreck v. United States, 577 F.2d 372 (6th Cir. 1978), *rev'd* 441 U.S. 780 (1979).

[57] 441 U.S. 780 (1979).

[58] *Id.* at 785.

[59] 497 N.E.2d at 904 (citing United States v. Caston, 615 F.2d 1111 (5th Cir. 1980)).

[60] *Id.* (citing United States v. Frazier, 705 F.2d 903 (7th Cir. 1983)).

[61] *Id.* (citing United States v. Stead, 748 F.2d 355 (6th Cir. 1984)).

[62] 475 U.S. 66 (1986).

the cost to society created by retrials as well as their detrimental effect upon the criminal justice system.[63]

Armed with these precedents—the United States Supreme Court denunciation of new trials and its own newly formulated standard—the Indiana Supreme Court applied its new declaration to Randy White's petition and found that petition wanting. The court's review of the transcript revealed that White had made no other case for withdrawal of his plea beyond the mere assertion that the trial court failed to make the single advisement set forth in Indiana Code section 35-35-1-2(a) regarding minimum sentencing.[64] White presented no facts to show he indeed did not know what the minimum sentences were nor had he alleged any other facts indicating his guilty plea was anything but intelligent, voluntary and knowing. Specifically, White did not claim that *but for* the trial court's error he would have decided to go to trial rather than to plead guilty.[65] Therefore, the supreme court concluded, Randy White had not borne his burden of showing by a preponderance of the evidence that his petition for post-conviction relief should have been granted and his plea withdrawn.[66]

IV. Evaluation of *White*

Upon preliminary analysis of *White*, one's first instinct is to dismiss it as incorrect on the basis of its flawed foundation and strained logic. The federal case law cited by the court vacillates from standard to standard, none of which the *White* court ever really adopted. In addition, the opinion made no distinction between cases decided on direct appeal, such as in *McCarthy v. United States*,[67] and cases decided on collateral attack, such as *United States v. Timmreck*.[68] Ultimately, this distinction is of little moment, but it casts an additional cloud on an opinion that also relied on the rationale of a case that did not involve a guilty plea at all, *United States v. Mechanik*.[69] These minor problems aside, one is further confronted with the decision's strained efforts to substantiate its credibility by attacking the *Austin v. State*[70] and *German v. State*[71] opinions.

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[63] *White*, 497 N.E.2d at 905.
[64] *Id.* at 906. *See supra* note 31.
[65] 497 N.E.2d at 906.
[66] *Id.*
[67] 394 U.S. 459 (1969).
[68] 441 U.S. 780 (1979).
[69] 475 U.S. 66 (1986).
[70] 468 N.E.2d 1027 (Ind. 1984).
[71] 428 N.E.2d 234 (Ind. 1981).

A. *White's Interpretation of* Austin *and* German *and its Effect*

To reiterate briefly, the Indiana Supreme Court in *German* held that the then-extant advisement statute, Indiana Code section 35-4.1-1-3,[72] mandated strict compliance by a trial court,[73] in order to determine that a guilty plea was entered voluntarily, knowingly and intelligently. As to the specific facts involved in *German*, this decision meant that advisements present in a written plea agreement were inadequate.[74] Considering the mandatory language of the statute—"The court *shall not* accept a plea of guilty from the defendant without first addressing the defendant"[75]—this result seems only logical. This wording is not discretionary, and the *German* holding is akin to the result the United States Supreme Court reached in *McCarthy v. United States*,[76] a case of direct appeal from a trial court's failure to follow Federal Rule 11. Shortly after *German*, and probably as its logical consequence, the Indiana legislature passed into law an amended advisement statute that includes mandatory language[77] similar to the earlier version but also adds the following: "Any variance from the requirements of this section that does not violate a constitutional right of the defendant is not a basis for setting aside a plea of guilty."[78] As a response to that enactment, the Indiana Supreme Court declared the new provision a nullity in *Austin*.[79] Although the *White* court intimates the *Austin* court backed away from its *German* rationale of strict construction of the mandatory language of the statute in order to pronounce a new rationale,[80] a careful reading shows the *White* court misconstrued *Austin*.

Austin stated that strict construction of the mandatory language is a reason for requiring strict compliance with the advisement. However,

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[72]*See supra* notes 19-26 and accompanying text.

[73]"We hold that it is the duty of the trial judge to comply strictly with the terms of IND. CODE § 35-4.1-1-3. . . ." 428 N.E.2d at 236.

[74]*Id.*

[75]*See supra* note 19.

[76]394 U.S. 459 (1969). The Supreme Court declared:

> [W]e hold that a defendant is entitled to plead anew if a United States district court accepts his guilty plea without fully adhering to the procedure provided for in Rule 11. This decision is based solely upon our construction of Rule 11 and is made pursuant to our supervisory power over the lower federal courts; we do not reach any of the constitutional arguments petitioner urges as additional grounds for reversal.

Id. at 463-64.

[77]"The court shall not accept a plea of guilty or guilty but mentally ill at the time of the crime, without first determining that the defendant . . ." IND. CODE § 35-35-1-2(a) (Supp. 1987).

[78]*Id.* § 35-35-1-2(c).

[79]468 N.E.2d 1027, 1029 (Ind. 1984).

[80]497 N.E.2d 893, 899 (Ind. 1986).

it is not the *only* reason.[81] Not having had reason to reach the constitutional issue prior to that time—as courts are wont to do[82]—the *Austin* court plucked up its courage and did just that. In holding that Dotsie Austin was entitled to an advisement of his minimum possible sentences, the court stated:

> An understanding of the range of possible sentences is, among other factors, essential to an informed judgment as to whether or not to enter a guilty plea. This is self-evident. An accused's entitlement to such advisements, therefore, flows from his *due process right* to be sheltered from the consequences of a guilty plea entered on less than an informed judgment and not from the legislative inclusion of it in its codification. The legislature may, as a matter of public policy, require advisements that are not of such dimension, but it could not eliminate the requirements of those essential to an informed judgment, which includes the one omitted by the court that accepted the guilty plea.[83]

The *Austin* court further found the legislature's harmless error provision in Indiana Code section 35-35-1-2(c) a nullity for a second reason—the harmless error doctrine is within the exclusive domain of the courts and therefore outside the domain of the legislature.[84] The *White* court attempted to tear this reasoning apart.

First, the *White* opinion interpreted the *Austin* court's "due process" right as being the bundle of advisements given to a defendant, then went on to show that not all those rights are afforded by the Constitution.[85] To the extent that not all these advisements are explicitly within the federal Constitution, the *White* court is correct.[86] After reaching this conclusion, the court also declared that the Indiana Constitution does not offer this "due process" right either. The court then explained how the *Austin* court's misapprehension of due process makes the opinion "not fully reliable."[87] The *White* court made one fundamental error in its analysis. It failed to consider the full *Austin* pronouncement that "[a]n accused's *entitlement* to such advisement . . . flows from his *due process right*. . . ."[88]

It is a basic tenet of criminal law that a guilty plea must be voluntary, knowing and intelligent; otherwise it has been obtained in violation of

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[81] 468 N.E.2d at 1028.
[82] *See, e.g.*, McCarthy v. United States, 394 U.S. 459 (1979).
[83] 468 N.E.2d at 1028 (Emphasis added).
[84] *Id.* at 1029.
[85] 497 N.E.2d at 897.
[86] *See infra* notes, 118-22 and accompanying text.
[87] 497 N.E.2d at 898.
[88] 468 N.E.2d at 1028 (Emphasis added).

the individual's due process rights.[89] The *White* court missed the point when it focused on the discrete advisements. It is the "waiver of . . . 'a known right or privilege'"[90] that is the constitutionally protected right with which *Austin* was concerned. The *Austin* court's decision to require, on *due process* grounds, an advisement of the minimum sentencing a defendant may be waiving in order to engender a proper plea was within its prerogative to interpret constitutional law and was within the bounds of dicta pronounced by *Boykin v. Alabama*.[91] Similarly, the *White* court's decision that due process was not better served by requiring this advisement waiving a right not explicitly set forth in the Constitution was *its* prerogative. It would have been much simpler to just say so, rather than to find a flaw in *Austin*, because there is adequate precedent for *White*'s reasoning.

The primary fact in *White* that must be remembered is that it concerned a *collateral* attack on a guilty plea, *vis-a-vis* a petition for post-conviction relief, not a direct appeal. The extent to which the *White* court recognized this fact exists in its citation to federal cases concerned with collateral attacks on pleas.[92] As the *White* case indicates and independent research reveals, there is no single method of approaching review of a guilty plea on collateral attack, be it by habeas corpus, motion to vacate sentence[93] or a petition for post-conviction relief. Traditionally, collateral attack on a guilty plea in the federal system requires a showing of a constitutional or jurisdictional defect rendering the judgment void, "a fundamental defect which inherently results in a complete miscarriage of justice, [or] an omission inconsistent with the rudimentary demands of fair procedure."[94] The translation to an Indiana post-conviction procedure framework is found generally in the rules for post-conviction remedies:

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[89] *See, e.g.*, Henderson v. Morgan, 426 U.S. 637, 647 (1976); Boykin v. Alabama, 395 U.S. 238, 243 n.5 (1969); McCarthy v. United States, 394 U.S. 459, 466 (1969).

[90] *McCarthy*, 394 U.S. at 466 (quoting Johnson v. Zerbst, 304 U.S. 458, 464 (1938)).

[91] A majority of criminal convictions are obtained after a plea of guilty. If these convictions are to be insulated from attack, the trial court is best advised to conduct an on the record examination of the defendant which should include, inter alia, an attempt to satisfy itself that the defendant understands the nature of the charges, his right to a jury trial, the acts sufficient to constitute the offenses for which he is charged and the *permissible range of sentences*. Commonwealth ex rel. West v. Rundle, 428 Pa. 102, 105-06, 237 A.2d 196, 197-98 (1968).

395 U.S. at 244 n.7 (Emphasis added).

[92] *E.g.*, United States v. Timmreck, 441 U.S. 780 (1978); Hill v. United States, 368 U.S. 424 (1962).

[93] 28 U.S.C. § 2255 (1982).

[94] Hill v. United States, 368 U.S. at 428; United States v. Timmreck, 441 U.S. at 783.

> (a) Any person who has been convicted of, or sentenced for, a crime by a court of this state, and who claims:
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> (1) that the conviction or the sentence was in violation of the Constitution of the United States or the constitution or laws of this state;
>
> (2) that the court was without jurisdiction to impose sentence;
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> . . .
>
> (6) that the conviction or sentence is otherwise subject to collateral attack upon any ground of alleged error heretofore available under any common law, statutory or other writ, motion, petition, proceeding or remedy;
>
> may institute at any time a proceeding under this Rule to secure relief.[95]

In the specific context of a collateral attack on a guilty plea, the goal is to determine whether the defendant entered his plea voluntarily, knowingly and intelligently,[96] as a matter of due process.[97] The entry of conviction upon a plea not so entered is fundamental error,[98] thereby creating justification for reversal by collateral attack. The major contention is what process is due to a guilty plea petitioner: what must a guilty plea defendant know in order to make a voluntary choice of pleading guilty rather than the alternative of standing trial?[99]

In Indiana, the legislature has determined a statutory framework, as discussed above, within which a trial court must work in order to satisfy itself that the guilty plea defendant has been accorded his due process rights.[100] Basically, these statutes require a trial court to assure itself that an unrepresented defendant has knowingly waived his right to counsel,[101] that there is a factual basis for the plea,[102] that the plea was not induced by promises, threats or force,[103] that the defendant understands the nature of the charge against him,[104] and that he waives certain rights and sentencing alternatives that might otherwise be available to him.[105] Unfortunately, despite the ease with which a trial court and

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[95] Ind. R. P. Post-Conviction Remedies 1 § 1.

[96] Henderson v. Morgan, 426 U.S. 637, 644-45 (1976); Boykin v. Alabama, 395 U.S. 238, 243 (1964); Davis v. State, 446 N.E.2d 1317, 1321 (Ind. 1983); Brown v. State, 435 N.E.2d 582, 584 (Ind. Ct. App. 1982).

[97] *Henderson*, 426 U.S. at 647.

[98] *Brown*, 435 N.E.2d at 584.

[99] North Carolina v. Alford, 400 U.S. 25, 31 (1970).

[100] *See supra* note 31 and accompanying text.

[101] Ind. Code § 35-35-1-1 (Supp. 1987).

[102] Ind. Code § 35-35-1-3 (Supp. 1987).

[103] Ind. Code § 35-35-1-3(a) (Supp. 1987).

[104] Ind. Code § 35-35-1-2(a)(1) (Supp. 1987).

[105] Ind. Code § 35-35-1-2(a)(2) (Supp. 1987).

a prosecutor could follow these steps, many pleas have been accepted without compliance with them, the *White* case being just one example of many. *German* and *Austin* provided one answer to these errors by mandating strict compliance with the statutes.[106] *White* provides another by implying the statutes incorrectly call for more from trial courts than due process requires.[107]

One must remember that, after all is said and done, the interpretation of the Constitution is the sole province of the courts.[108] Regardless of how the legislature may interpret it, the courts remain the final arbiters of its construction and, thus, of adjudging a guilty plea defendant's rights to due process. To that end, the *White* court has declared that certain portions of the statutes are immutably required by due process: "[U]nless the record reveals that the defendant knew or was advised at the time of his plea that he was waiving his right to a jury trial, his right of confrontation and his right against self incrimination, *Boykin* will require that his conviction be vacated," or if the plea is entered "after coercion, judicial or otherwise."[109] The absence of the other legislative requirements from a guilty plea record, such as the advisement of Randy White's minimum possible sentence, is relegated to the fuzzy zone of "colorable claims for relief"[110] upon which a petitioner may prevail only by showing, by a preponderance of evidence, that he has actually been misled in choosing to plead guilty over his alternatives.[111] To the extent that this conclusion conforms to accepted procedures on post-conviction relief, the Indiana Supreme court appears to be correct. However, insofar as *White* purports to reflect a proper standard of attacking a guilty plea, it is incorrect.

The issue ultimately is whether the defendant voluntarily, knowingly, and intelligently elected to plead guilty. Therefore, the inquiry should be whether, given the evidence in the record at the post-conviction proceeding, the petitioner has shown by a preponderance of the evidence that he was not accorded due process. To put the onus on the petitioner at the post-conviction proceeding to show he was actually misled, as *White* requires, is to further relieve the trial court and the prosecution from establishing an adequate record of the plea proceedings as mandated by *Boykin* and its collateral attack progeny.[112] Certainly, a defendant's having been misled could be part of the evidence establishing the lack

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[106]*See supra* notes 72-84 and accompanying text.
[107]497 N.E.2d at 897.
[108]Fountain Park Co. v. Hensler, 199 Ind. 95, 107, 155 N.E. 465, 469 (1927).
[109]497 N.E.2d at 905.
[110]*Id.* at 906.
[111]*Id.*
[112]*See supra* notes 93-99 and accompanying text.

of voluntariness and intelligence of his plea. But to make this single inquiry, in addition to the four immutable requirements set forth above,[113] runs contrary to the clear message of *Boykin*.

This procedural distinction is, of course, merely an intellectual diversion, when in fact the issue in *White* is whether the trial court's failure to follow the statute is essentially harmless error.[114] In other words, is the absence of an advisement of a minimum possible sentence a denial of due process? Although a liberal and well-devised opinion from the Indiana Court of Appeals has described all the statutory provisions as of constitutional dimension,[115] the fact remains that the Indiana Supreme Court, as the highest court in the state, is the final authority in this state on the parameters of due process set forth in both the state and federal constitutions. In *White*, the supreme court simply disagreed with the court of appeals and implicitly declared that, given the facts of Randy White's case, the error in failing to advise him of his minimum possible sentence was not of constitutional dimension *vis-a-vis* due process. The trial court's error was not sufficient to afford White collateral relief.[116]

This *result* on the basis of harmless error and lack of prejudice has sufficient precedent,[117] even if *White*'s underlying rationale does not. What remains to be seen is *White*'s application in instances of other omissions from the statutory advisements.

B. The Advisements Required by Due Process

The *White* court set forth four advisements and/or inquiries absolutely mandated by due process. They are advisement of a defendant's waiver of his right to a jury trial, his right of confrontation, and his right against self-incrimination and, impliedly, an inquiry as to whether the plea has been coerced.[118] The three advisements of waiver were borne of the federal Constitution and are explicitly set forth in *Boykin v. Alabama*.[119] The absence of any of these advisements in a plea proceeding is a clear violation of due process, thereby voiding the conviction based

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[113]*See supra* text accompanying note 109.

[114]*See White*, 497 N.E.2d at 905. *See also* United States v. Timmreck, 441 U.S. 780, 783 (1978) ("Such a violation is neither constitutional nor jurisdictional."); Hill v. U.S., 368 U.S. 424, 428 (1962).

[115]Jones v. State, 467 N.E.2d 757 (Ind. Ct. App. 1984).

[116]*White*, 497 N.E.2d at 905-06.

[117]*E.g.*, Hill v. Lockhart, 474 U.S. 42 (1985); United States v. Timmreck, 441 U.S. at 783.

[118]*See supra* note 109 and accompanying text.

[119]395 U.S. at 243. *See also* McCarthy v. United States, 394 U.S. 459, 466 (1969).

thereon.[120] The inquiry into whether a defendant has been coerced is the implied converse of an inquiry into voluntariness. This, too, has been deemed essential to due process in *Brady v. United States*.[121] The Indiana statutes require certain other advisements not set forth in *White*.[122] Some of them should have been listed in *White* as evocative of due process; others were rightfully omitted, insofar as *White* applies only to collateral proceedings.

Evidently, Randy White appeared at his plea proceeding with counsel; therefore, the advisement of waiver providing that "[a] plea of guilty . . . shall not be accepted from a defendant unrepresented by counsel who has not freely and knowingly waived his right to counsel" was not at issue.[123] *Rice v. Olson*[124] elevated the knowing waiver of this constitutional right to the status of an element of due process in the guilty plea setting. Although the *White* scenario did not need to address this matter, the case's reliance on the *Boykin* factors as being absolute rights leads to the conclusion that if the matter should arise in the proper situation, the Indiana Supreme Court would find prima facie reversible error in the absence of waiver of counsel.

Another element not addressed by *White* but still undeniably an element of due process in the guilty plea proceeding is whether the defendant "understands the nature of the charge against him."[125] It was early established in *Smith v. O'Grady*[126] that a defendant must understand the nature of the charge against him before he can voluntarily and intelligently plead guilty. The Supreme Court later applied this requirement to collateral attacks in *Henderson v. Morgan*.[127] Under the circumstances, the Indiana Supreme Court can do no less than recognize this factor also, despite its omission from the list in *White*. The constitutional mandate interpreted by the United States Supreme Court demands it.

One advisement in Indiana Code section 35-35-1-2 that has not yet been treated as of constitutional dimension in the guilty plea setting is the waiver of a "public and speedy trial by jury."[128] *Barker v. Wingo*[129]

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[120]*Boykin*, 395 U.S. at 243.

[121]397 U.S. 742 (1970).

[122]*See supra* note 31 and accompanying text.

[123]Ind. Code § 35-35-1-1 (Supp. 1987).

[124]324 U.S. 786, 791 (1945).

[125]Ind. Code § 35-35-1-2(a)(1) (Supp. 1987). Closely associated with this determination is the element requiring that "[t]he court shall not enter judgment upon a plea of guilty . . . unless it is satisfied from its examination of the defendant or the evidence presented that there is a factual basis for the plea." Ind. Code § 35-35-1-3(b) (Supp. 1987).

[126]312 U.S. 329, 334 (1941).

[127]426 U.S. 637, 645 (1976); *see also* North Carolina v. Alford, 400 U.S. 25 (1970).

[128]Ind. Code § 35-35-1-2(a)(2)(A) (Supp. 1987).

[129]407 U.S. 514, 515-16 (1972).

clearly established a state court defendant's right to a speedy trial under the Sixth Amendment; sound policy supports the argument in favor of raising this right to the status of the *Boykin* rights.[130] For example, many defendants do not make bail and must remain incarcerated in local jails until trial and sentencing. Notoriously, these local jails—even in rural areas—present such awful conditions that a defendant would willingly plead guilty to gain transport to a perhaps less troublesome facility. A defendant would surely want to know that a speedy trial is available to him in order for him to make an informed choice whether to plead guilty or to wait shortly for a trial. However, until the United States Supreme Court adopts the position that the right to a speedy trial is constitutionally mandated in the due process waiver of a pleading defendant, it is highly unlikely, as evidenced by *White*, that the Indiana Supreme Court will take such a position.[131] Additionally, one could argue that a defendant could infer his right to a speedy trial by the speed with which the state will allow him to plead guilty.

The next advisement of Indiana Code section 35-35-1-2, and the primary subject of *White*, is the advisement of the minimum and maximum sentences and the possibility of increased or consecutive sentences.[132] The *Boykin* majority alluded to the constitutional dimension of this generic advisement in dictum when it cited to a state court opinion: "the trial court is best advised to conduct an on the record examination of the defendant which should include . . . the permissible range of sentences."[133] However, in the absence of actually misleading a defendant into pleading guilty because of his misunderstanding of the possible sentences,[134] the failure to make this advisement is usually relegated to a designation as a technical violation only.[135] The usefulness of further

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[130]*See* the dissent from the Supreme Court's denial of certiorari in Johnson v. Ohio, 419 U.S. 924 (1974). Justice Douglas, joined by Justices Brennan and Marshall, states that enumeration in *Boykin* is "illustrative, not exhaustive" and should therefore include the right to a speedy trial. 419 U.S. at 926 (Douglas, J., dissenting).

[131]However, the Indiana Supreme Court, relying on the holding of German v. State, 428 N.E.2d 234 (Ind. 1981), held that on a petition for post-conviction relief, a defendant's plea of guilty would be vacated where the trial judge accepting such plea failed to inform the defendant that by so pleading, he was thereby waiving his right to a speedy trial. Hayenga v. State, 463 N.E.2d 1383, 1384 (Ind. 1984).

[132]IND. CODE § 35-35-1-2(a)(3) (Supp. 1987).

[133]Boykin v. Alabama, 395 U.S. at 244 n.7 (1969) (quoting Commonwealth *ex rel.* West v. Rundle, 428 Pa. 102, 105-06, 237 A.2d 196, 197-98 (1968)).

[134]*See, e.g.*, United States v. Sharon, 812 F.2d 1233 (9th Cir. 1987) (special parole not described); United States v. Hawthorne, 806 F.2d 493 (3d Cir. 1986) (failure to inform of imposition of restitution).

[135]*See, e.g.*, United States v. Timmreck, 441 U.S. 780 (1979). *See also* Hill v. Lockhart, 474 U.S. 52 (1985).

argument that this advisement is paramount to a defendant's due process rights is minimal.

The final element set forth in the Indiana statutes declares that if a trial court accepts a plea premised upon an agreement, the court is bound by the terms of that agreement.[136] As a practical matter, this information is essentially superfluous. Why would a defendant choose to enter into a plea agreement if he did not fully intend to get what he bargained for? This information probably has little to do with any due process rights but is merely a vestige of the prior advisement that a trial court was *not* bound by any plea agreements.[137] The failure to make this earlier advisement *was* a violation of due process.[138] Under the current version of the statute this advisement has little actual value for purposes of establishing grounds for collateral attack.

Although the foregoing elements were established by the Indiana legislature and do not all have *per se* constitutional derivation, most of the factors do have precedential force from the federal courts in their interpretation of the United States Constitution by reason of the Fourteenth Amendment[139] as well as by direct mandate from the Due Process Clause of the Fifth Amendment.[140] Of course, not only are states bound by the Constitution in their interpretation of constitutional rights, particularly those of due process, but they may also require a higher standard. Inasmuch as the Indiana Supreme Court has impliedly declared in *White* that the General Assembly will not govern the definition of due process in creating a higher standard than that required of federal courts, the question remains whether there exists anything else which is inherent in due process which the supreme court may also have ignored.

The Indiana Constitution has been oft-neglected in the consideration of a pleading defendant's due process rights. Two sections are of particular application in such a case:

> All courts shall be open; and every person, for injury done to him in his person, property, or reputation shall have remedy by due course of law. Justice shall be administered freely, and without purchase; completely, and without denial; speedily, and

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[136] IND. CODE § 35-35-1-2(a)(4) (Supp. 1987).

[137] IND. CODE § 35-4.1-1-3(e) (repealed 1981).

[138] *See, e.g.*, Pharms v. State, 477 N.E.2d 334 (Ind. Ct. App. 1985).

[139] *See, e.g.*, Robbins v. State, 251 Ind. 313, 321, 241 N.E.2d 148, 153 (1968). For federal cases involving state court defendant, *see, e.g.*, Boykin v. Alabama, 395 U.S. 244 (1969); Henderson v. Morgan, 426 U.S. 637 (1976).

[140] "No person shall . . . be deprived of life, liberty or property, without due process of law. . ." U.S. CONST. amend. V. For two examples of federal defendants, see McCarthy v. United States, 394 U.S. 459 (1969) and United States v. Timmreck, 441 U.S. 780 (1979). However, both of these cases focused upon FED. R. CRIM. P. 11.

> without delay.[141]
>
> In all criminal prosecutions, the accused shall have a right to a public trial, by an impartial jury, in the county in which the offense shall have been committed; to be heard by himself and counsel; to demand the nature and cause of the accusation against him, and to have a copy thereof; to meet the witnesses face to face, and to have compulsory process for obtaining witnesses in his favor.[142]

The combined meaning of these two provisions tracks fairly closely with the same rights set forth above and interpreted within the United States Constitution.[143] The state rights identical to the federal rights would receive similar application by the supreme court. For example, the state right to jury trial must be announced to a pleading defendant.[144] On the other hand, there seems little doubt that as to the interpretation of the federal right to a speedy and public trial, the Indiana Supreme Court would treat the same state constitutional provision with like regard. That is, such a right is not within the meaning of due process.[145] It does not appear, from the tenor of *White*, that the supreme court will expand the Indiana Constitution's "due course of law" beyond that prescribed for the United States Constitution's "due process of law."[146] However, there is one very serious deficiency in Indiana's criminal procedure which either will have to actually be rectified or must also be included in a pleading defendant's advisement: the right to a direct appeal.

The Indiana Constitution has been interpreted and applied by Indiana courts as giving criminal defendants the right to appeal.[147] Although there is contradictory authority on the issue,[148] the most recent statement on the matter appears in *Judy v. State*.[149] In that case the supreme court reviewed Steven Judy's waiver of his right to appeal his death penalty case. Acknowledging that review of the death penalty phase itself was not waiveable, the court declared that Judy's waiver of his right to

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[141]IND. CONST. art. 1, § 12.

[142]*Id.* at § 13.

[143]*See supra* notes 118-21 and accompanying text.

[144]*See supra* notes 31 and accompanying text.

[145]*See supra* notes 128-31 and accompanying text.

[146]*See* White, 497 N.E.2d at 897 n.4, and cases cited therein ("due process" is interchangeable with "due course").

[147]*See* Judy v. State, 275 Ind. 145, 157, 416 N.E.2d 95, 101 (1981); Peterson v. State, 246 Ind. 452, 456, 206 N.E.2d 371, 372 (1965); Woods v. State, 426 N.E.2d 107 (Ind. Ct. App. 1981); *see also* IND. CODE § 35-38-4-1 (Supp. 1987).

[148]*See, e.g.*, Robbins v. State, 251 Ind. 323, 325, 242 N.E.2d 925, 927 (1969); *In re* Pisello, 155 Ind. App. 484, 488, 293 N.E.2d 228, 230 (1973).

[149]275 Ind. 145, 416 N.E.2d 95 (1981).

appeal his conviction must be *knowing*, *intelligent* and *voluntary*.[150] Although the court declared in an earlier case, *Riner v. Raines*,[151] that the right to appeal a criminal conviction is not a necessary element of due process,[152] the *Judy* decision belies that interpretation. This issue would ordinarily be of no moment but for the fact that pleading defendants are typically confined to challenging their pleas by collateral attack rather than by direct appeal.

For reasons that are unclear, in the early 1980's the Indiana appellate courts began ruling that a criminal defendant could not attack his plea by a motion to correct error and direct appeal.[153] Evidently, these holdings express the courts' beliefs that the language in the Indiana Rules of Civil Procedure and of Criminal Procedure pertaining to the appeal from judgments referring directly to "trial," "verdict," or "decision,"[154] should be interpreted to preclude those instances where one pleads guilty rather than proceeds to trial. It is difficult to understand these holdings, however, in light of the clearly constitutional dimensions of the right, and the language of Indiana Code section 35-38-4-1(a): An appeal to the supreme court or the court of appeals may be taken by the defendant: (1) as a matter of right from any judgment in a criminal action; and (2) in accordance with this chapter.[155]

A plea by a criminal defendant is just as much a conviction as if he had gone to trial.[156] Furthermore, the rule for post-conviction relief affords guilty plea defendants the opportunity to file a belated appeal.[157] It is therefore perplexing why attacks on guilty pleas are reduced to the realm of petitions for post-conviction relief.

This examination of the law leads to the inevitable conclusions that the appellate courts are wrong and that the law does afford pleading defendants the opportunity to appeal, or that the law actually does not afford this right. In either circumstance, the law is equally clear that if defendants convicted after trial do have the right, but defendants convicted after pleading do not, then the pleading defendants are being denied their rights under equal protection of the law.[158] Although the

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[150]*Id.* at 150, 416 N.E.2d at 97 (emphasis added).

[151]274 Ind. 113, 409 N.E.2d 575 (1980).

[152]*Id.* at 118, 409 N.E.2d at 578.

[153]*See, e.g.*, Stone v. State, 444 N.E.2d 1214 (Ind. Ct. App. 1983); Woods v. State, 426 N.E.2d 107 (Ind. 1981).

[154]*See* Ind. R. Civ. P. 59.

[155]Ind. Code § 35-38-4-1 (Supp. 1987).

[156]*See, e.g.*, Boykin v. Alabama, 395 U.S. 238, 242 (1969).

[157]Ind. R. P. Post-Conviction Remedies 2 § 1 provides: "Any defendant convicted after a trial or plea of guilty may petition the court of conviction for permission to file a belated motion for new trial . . ."

[158]"No State shall make or enforce any law which shall . . . deny to any person within its jurisdiction the equal protection of the laws." U.S. Const. amend XIV, § 1.

initial premise of the following statement regarding due process is flawed in the wake of *Judy*, it is hard to deny the ultimate import of this declaration by the Indiana Supreme Court: "[T]he right to appeal in criminal cases is not a necessary element of due process although *to the extent that a state provides such a right, the equal protection clause would require all affected to be treated alike*."[159] Thus, this right is elevated to a federal due process issue, and the failure of the Indiana courts to advise of this right is reversible error.

Two options are open to cure this serious flaw in the system. The ideal solution would be for the courts to interpret the Indiana Constitution to include the right to appeal and thereafter to apply such a right equally among defendants. The second option would be for the General Assembly to amend the appropriate statutes and trial rules to invoke clearly this due process right to pleading defendants. Merely to advise a pleading defendant that by pleading guilty he *waives* the right to appeal because this right concerns the procedure *surrounding the plea* is *not* an option. Rather, a pleading defendant must be informed of his right to a direct appeal *which may be waived* if such waiver is voluntary, knowing and intelligent.[160]

The ramifications of properly inserting this right in the matter of due process may have little or no practical effect on current procedure. It is fairly common knowledge that most attacks on guilty pleas fall outside the limitations for a direct appeal, either with respect to the passage of time[161] or as a substantive matter of the belated appeals requirements.[162] Collateral attacks are typically lodged when a defendant discovers he may be charged as an habitual offender[163] if he cannot avoid an earlier guilty plea conviction. The absence of an advisement regarding the defendant's right to appeal constitutes fundamental error as a denial of equal protection under the law. Failure of a trial court to make a record of this right ranks with a similar failure to make the *Boykin* advisements in mandating reversal. Futhermore, the effect on the possibilities open to defendants who can timely perfect an appeal could be enormous because *McCarthy v. United States*[164] clearly mandates reversal for *any* omission from the federal guilty plea statutes if brought on direct appeal.

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[159] Riner v. Raines, 274 Ind. 113, 118, 409 N.E.2d 575, 578 (1980) (emphasis added).

[160] *But see* United States v. Frazier, 705 F.2d 903, 908 n.8 (7th Cir. 1983) (in which the opinion appears to deal with the right to appeal a related motion to suppress, but uses unfortunately broad language such that it *could* be construed as the right to appeal the plea).

[161] IND. R. CIV. P. 59.

[162] IND. R. P. POST-CONVICTION REMEDIES 2.

[163] IND. CODE § 35-50-2-8 (Supp. 1987).

[164] 394 U.S. 459, 463-64 (1969).

Although it addresses the construction of the federal rule and its specific terms, the import of the *McCarthy* opinion is that an appealing defendant should not have to bear the burden of disproving the voluntariness of his plea. Rather, all resort to fact-finding is eliminated and the court must determine error on the plea record alone.[165] Omissions are *prima facie* reversible error. The same result would be particularly appropriate in Indiana where the motion to correct error does not contemplate additional fact-finding after judgment, except for newly discovered evidence.[166]

The problem that continues to fester in all this, of course, is the effect of the recent statutory amendment providing: "Any variance from the requirements of this section that does not violate a constitutional right of the defendant is not a basis for setting aside a plea of guilty."[167] Can the courts apply this "harmless error" standard to get around the mandate of *McCarthy v. United States*?[168]

A differently composed Indiana Supreme Court concluded, in *Austin v. State*,[169] that the General Assembly "may not fetter the judiciary with its concept of harmless error"[170] and declared Indiana Code section 35-33-1-2(c) a nullity. Although criticized heartily by the *White* court,[171] *Austin* was without doubt correct in this regard. The due process accorded to pleading defendants is, by and large, governed by the advisement of waiver of federal constitutional rights. This advisement procedure itself emanates from the Constitution. In most respects then, the "harmless error" provision is an empty vessel—it applies to virtually nothing raised in the statutes. The "harmless error" provision is also of no moment in light of the clear import of the language of the Supreme Court in *Chapman v. California*[172] when it addressed a state constitutional provision undercutting a federal constitutional right: "With faithfulness to the constitutional union of the states, we cannot leave to the States the

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[165] *Id.* at 469.

[166] IND. R. CIV. P. 59(A)(6).

[167] IND. CODE § 35-35-1-2(c) (Supp. 1987).

[168] A similar provision is currently in place in FED. R. CRIM. P., Rule 11(h): "Any variance from the procedures required by this rule which does not affect substantial rights shall be disregarded." To date, the Supreme Court has not addressed a challenge to the validity of this provision although it has been used in matters of direct appeal by lower courts. *See, e.g.*, United States v. Fentress, 792 F.2d 461, 465 (4th Cir. 1986); United States v. De le Puente, 755 F.2d 313, 314-15 (3d Cir. 1985); *but see* United States v. Ramos, 810 F.2d 308, 312 (1st Cir. 1987) (this circuit may not follow Rule 11(h) when defendant moves to withdraw his plea).

[169] 468 N.E.2d 1027 (1984).

[170] *Id.* at 1029.

[171] White v. State, 497 N.E.2d 893, 897-99 (Ind. 1986).

[172] 386 U.S. 18 (1967).

formulation of the authoritative laws, rules, and remedies assigned to protect people from infractions by the States of federally guaranteed rights.''[173] This is not to say the Indiana courts may not find a violation of a constitutional right is harmless error pursuant to the judicially formulated Rule 61 of the Indiana Rules of Civil Procedure.[174] That ability is specifically reserved in *Chapman*.[175] However, that case *does* negate subsection 2(c) and denies to the General Assembly the power to formulate a rule of its own. Thus, subsection 2(c) can have no legal effect on the review of a guilty plea in Indiana, either on collateral attack or direct appeal. But can the Indiana courts still find ''harmless error'' on direct appeal?

Because *McCarthy v. United States*[176] was not decided on constitutional grounds but on rules of statutory construction, the answer to that question has not yet been decided by the Supreme Court. However, the very nature of a direct appeal is going to make it extremely difficult to find harmless error because review is confined to the guilty plea record. Thus, almost *any* omission from the statutes is error for lack of evidence otherwise. The defendant has no burden to produce anything *but* the record. Realistically, a challenge to the ever thorny failure to advise of the minimum or maximum sentences will be naught if the defendant was sentenced within the parameters of the possible sentences, as in *White*. Such failure will probably still be deemed harmless error pursuant to Rule 61. Except for being within the general due process considerations regarding an advisement of the consequences of a plea, this advisement is not otherwise supported by an independent constitutional right. So, unless the Indiana Supreme Court changes its mode of review drastically in the near future, it is hardly likely it will follow *McCarthy*'s method of statutory construction to require strict adherence to the statute on this particular element, even on direct appeal. All the other elements, however, have been specifically denominated to be of federal dimension and not omissible in such instance.[177] Thus, the Indiana Supreme Court will have to re-examine some of its current practices applicable to collateral attack when faced with a direct appeal.

C. *Retroactive Application*

One of the major questions arising from *White* is whether its standard should be applied retroactively, that is, to all reviews of guilty pleas

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[173]*Id.* at 21.
[174]Ind. R. Civ. P. 61.
[175]386 U.S. at 21-22.
[176]394 U.S. 459 (1969).
[177]*See supra* notes 118-121 and accompanying text.

without regard to when they were entered. The *White* court hinted at the answer to this question in its disposition of Randy White's petition: "If appellant has any other basis upon which to establish that his plea was not voluntary and intelligent, he may file a new petition."[178] Similar notations were made in subsequent cases decided by the Indiana Supreme Court.[179]

Patton v. State,[180] an Indiana Court of Appeals case, was the first to confront the problem of retroactivity. Patton's appellate brief reached the court after the *White* decision, and in it he argued that *White* should be limited to a prospective application only. The court of appeals disagreed, providing, however, only the rationale noted above: the *White* standard was applied to Randy White's petition.[181] This stands, the court concluded, as precedent for the proposition that *White* has been given retroactive effect. The court determined that *White* was to be applied retroactively, despite the fact that the *White* court did not elucidate the reasons for retroactivity. The *Patton* court went no further in its explication of the problem.[182]

Even though the precedent for retroactivity has been established, inquiry into the question remains fruitful, particularly given that the *Patton* decision does not address the precise contours of the argument which may be made.

The prior case of *German v. State*[183] was given prospective application only. The supreme court, in *Martin v. State*,[184] held that "there is no sound reason for retroactive application of *German*."[185] The decision to apply *German* prospectively should shed some light on the rationale behind the decision to apply *White* retroactively.

It should be noted that, as a general matter, constitutional prohibitions against *ex post facto* laws do not apply to judicial precedent. The focus of *ex post facto* prohibitions is upon the legislature and the

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[178]White v. State, 497 N.E.2d 893, 906 (Ind. 1986).

[179]*E.g.*, Simpson v. State, 499 N.E.2d 205, 206 (Ind. 1986); Reid v. State, 499 N.E.2d 207, 208 (Ind. 1986); Merriweather v. State, 209, 211 (Ind. 1986).

[180]507 N.E.2d 624 (Ind. Ct. App. 1987).

[181]*Id.* at 626.

[182]*Id.*; *see also* Buskirk v. State, 511 N.E.2d 305 (Ind. 1987). Although the *Buskirk* case occurred outside the survey period, it is noteworthy because Justice Pivarnik's opinion held *White* to be retroactive. Unfortunately, *Buskirk* cited *Patton* as precedent. *Id.* at 305. The *Patton* court stated, "Explication of the policy and its constitutional ramifications is best left to the highest court of our state." 507 N.E.2d at 626.

[183]428 N.E.2d 234 (Ind. 1981).

[184]480 N.E.2d 543 (Ind. 1985) (clarifying conflict between Johnson v. State, 471 N.E.2d 1107 (Ind. 1984) and William v. State, 468 N.E.2d 1036 (Ind. 1984)).

[185]*Martin*, 480 N.E.2d at 547.

desire to limit its authority.[186] The litigant seeking to compel, as with the *German* standard, or avoid, as with the *White* standard, retroactivity is thus left to a common law, or perhaps due process, approach to the issue. The latter analysis usually employs three factors, none of which apparently predominate. They are: (a) the purpose to be served by the new standards, (b) the extent of reliance by law enforcement authorities on the old standards, and (c) the effect on the administration of justice of a retroactive application of the new standards.[187]

The purpose of *German*'s requirement of strict compliance with the statute relating to guilty pleas was two-fold. It was designed to insure proper advice to the pleader and create ease of appellate review.[188] *German* did not affect the fact-finding process. *White*, on the other hand, does affect the fact-finding process intimately. The ultimate fact to be found in a post-conviction proceeding for review of a guilty plea is whether the plea was entered knowingly, voluntarily and intelligently.[189] *White* directly bears upon this issue. *White* asked, would the petitioner have pleaded guilty if the omitted advisement had been given?[190] A finding of a potential change in plea is highly probative on the issue of whether the plea was entered voluntarily and intelligently. Thus, the purpose to be served by the new standards is to reflect accurately the voluntariness of the plea. The purpose of the *White* standard, therefore, is to serve as a more accurate barometer of the correct result. That is, was the guilty plea accepted correctly? This purpose militates strongly in favor of a retroactive application. Standards which bear upon the fact-finding process should generally be applied uniformly and retroactively.[191]

However, under the foregoing, unfairness can and probably did result to petitioners in a position such as White. This is a component of the second portion of the analysis, the factor of the degree of reliance by petitioners. Usually, the test applied is whether there was reliance by law enforcement officials, especially in the area of search and seizure law. However, Judge Shields in *Bryant v. State*[192] aptly noted that when the rule (or standard) under consideration is more restrictive in nature, the analysis more germane is the degree of the reliance by defendants (or petitioners).

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[186]*See* Sumpter v. State, 264 Ind. 117, 340 N.E.2d 764, *cert. denied*, 425 U.S. 952 (1976).

[187]Bryant v. State, 446 N.E.2d 364, 367 (Ind. Ct. App. 1983) (*quoting* Stovall v. Denno, 388 U.S. 293 (1967)). *See generally* Rowley v. State, 483 N.E.2d 1078 (Ind. 1985).

[188]*Martin*, 480 N.E.2d at 547.

[189]*See supra* notes 89 and accompanying text.

[190]497 N.E.2d at 906.

[191]*See* Desist v. United States, 394 U.S. 244 (1969).

[192]446 N.E.2d 364, 367 (Ind. Ct. App. 1983).

Randy White's brief, and those in other cases which follow closely the *White* decision, demonstrate the degree of petitioners' reliance. White did resist transfer on the ground that the issue of reexamination of the standard of *German* and *Austin* was not appropriately before the Indiana Supreme Court. Yet White seemed to argue only that *German* and *Austin* mandated vacation of his plea.[193] Thus, the degree of reliance was substantial. Moreover, the new rule, while having its basis in prior case law, is a radical and abrupt departure from immediate prior precedent. *German* and *Austin* were overruled by name and in full.

White does seek to ameliorate the harshness that the abrupt change caused. Randy White was given, somewhat cryptically, a second chance to vindicate his position. The disposition does give White the opportunity to refile his petition, provided he has "any *other* basis upon which to establish that his plea was not voluntary and intelligent."[194] The extent to which this gives White the chance to relitigate the voluntariness of his plea, particularly concerning the issues which he raised in his first appeal, is problematic. As *Patton* noted, there are pitfalls in relitigation, not the least of which are waiver and estoppel.[195] Nevertheless, Randy White was given the chance to at least reopen his case despite the problems which reopening may create.

The third component of the retroactivity analysis is that of the burden on the administration of justice. The *White* court viewed the overturning of guilty pleas as an inordinate burden to the system. The court wrote:

> Routine reversal of convictions on technical grounds imposes substantial costs on society. Chief Justice Designate Rehnquist recently enumerated these costs, and we paraphrase his description of them. Jurors, witnesses, judges, lawyers, and prosecutors may be required to commit further time and other resources to repeat a trial which has already taken place. The victims are caused to relive frequently painful experience in open court. The erosion of memory and the dispersal of witnesses may well make a new trial difficult or even impossible. If the latter is the case, an admitted perpetrator will be rewarded with freedom from prosecution. Such results prejudice society's interest in the prompt administration of justice, reduce the deterrent value of any pun-

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[193]*White*, 497 N.E.2d at 895.

[194]*Id.* at 906 (emphasis added).

[195]In *Patton*, the petitioner argued that, beyond waiver and estoppel, he might be subject to an increased sentence under the revised rules. Patton's argument made in the context of requesting a remand for the purpose of meeting the *White* standard, was rejected. 507 N.E.2d 624, 627 (Ind. Ct. App. 1987).

ishment, and hamper the rehabilitation of wrongdoers.[196]

Fortunately, the court which created *German* and *Austin* concurred in this assessment. In limiting *German* to prospective application only, the court wrote in *Martin v. State*:

> Retroactive application could only result in the vacating of many judgments resting upon guilty pleas actually given knowingly and voluntarily or if not so given, nevertheless, given under circumstances rendering deficiency in the advisements harmless error. The burden upon the administration of justice in such cases is overwhelming.[197]

Thus, even though the *Martin* and *White* courts disagreed as to the result to be reached regarding prospective and retrospective application of the respective standards, both agreed in their assessment of the burden to the administration of justice with regard to the standard.

The traditional analysis of retroactive application of precedent therefore suggests that *White* be given full retroactive effect. *White* bears upon the ultimate issue of the correctness of a guilty plea, seeks to limit by its own terms the harshness of overturning *German* and *Austin*, and will work a reduction, in the long run, of vacation of guilty pleas and the resultant full criminal litigation. Retroactive application is probably the correct result, particularly because the *White* court overruled *Austin* and thus foreclosed any contentions of whether the court's decision impairs vested, substantive rights to persons having pleaded guilty under the previous standards.

V. Effect of *White* on Indiana Post-Conviction Procedure

As stated earlier, the Indiana Rules of Procedure for Post-Conviction Remedies are designed to effectuate the following goals: a simple and expeditious procedure; a single procedure obviating the need for state *habeas corpus* or *corum nobis* proceedings; disposition on the merits of the claims whenever possible; and elimination of subsequent post-conviction petitions by the same petitioner concerning the same conviction.[198]

One must wonder to what extent the changed standard of review announced by *White v. State* will serve these goals. Two caveats are in order. First, *White* is merely a change in the way in which guilty pleas are taken in terms of the requisite advisements. Second, and relatedly, *White* is not procedural. It does nothing to change the manner of

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[196] *White*, 497 N.E.2d at 905.

[197] *Martin v. State*, 480 N.E.2d 543, 547 (Ind. 1985).

[198] *See supra* text accompanying notes 15-16.

processing post-conviction cases. Nevertheless, *White* may, as a practical matter, have an impact on the degree to which the post-conviction relief rules serve the stated and implicit goals.

First, *White*'s immediate impact is to impose a new threshold technical requirement with regard to pleading. To be successful, a petitioner must allege facts which could, if proven, lead to the conclusion that, but for the omitted advisement, the petitioner would not have pleaded guilty.[199] Though the pleading requirement may be relatively simple, it is still a threshold requirement. Inartful or unaware pleaders, particularly those appearing *pro se*, could lose the opportunity to litigate fully their claim should they fail to allege both the necessary result and cause. That is, the defendant *must* allege that a plea of guilty would not have been entered if the trial court had given its constitutionally required advisement. Setting to one side the issue of the propriety of requiring such proof, there is little doubt that disposal of claims on pleading grounds has become a much greater possibility. This approach appears to be in conflict with the stated desire to dispose of claims on their merits.

Second, *White* actually increases, rather than decreases, the probability of subsequent petitions concerning the same guilty plea. As noted, the standard for guilty pleas has changed five times in less than ten years.[200] While the reality may differ from the perception, the perception must be that a second petition for post-conviction relief gives at least some opportunity for further review under a new and different standard. The *White* case itself demonstrates this. Randy White was given, in the court's disposition, a new opportunity to allege and prove facts which would meet the standard.[201] Thus, White's case results in two trial court decisions and inevitable appellate court reviews. This result was extended to all cases in which trial court disposition had not yet occurred when White was handed down.[202] It may fairly extend to all potential litigants seeking a "second bite at the apple" under a new standard, regardless of whether that standard actually increases the chances of success (which

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[199] *White*, 497 N.E.2d at 905 ("[The petitioner] needs to *plead* specific facts from which a finder of fact could conclude. . . ." (emphasis added)).

[200] *See supra* notes 1-5 and accompanying text.

[201] *White*, 497 N.E.2d at 906.

[202] *E.g.*, Simpson v. State, 499 N.E.2d 205, 206 (Ind. 1986); Reid v. State, 499 N.E.2d 207, 208 (Ind. 1986); Merriweather v. State, 499 N.E.2d 209, 211 (Ind. 1986). In all three cases, the court wrote:

> We note that appellant's petition for post-conviction relief and proceedings thereon were predicated on case law existing before our recent decision in *White* which reviewed and revised the applicable burden of pleading and proof. Therefore, if appellant has any other basis upon which to establish that his plea was not voluntary and intelligent, he may file a new petition.

it does not). As more of the issues raised by *White* become settled, litigation may decrease. Yet, at present, there can be little doubt that more, not less, litigation is the immediate result of *White*. Certainly there is no empirical evidence to suggest that post-*White* pleaders will be deterred from pursuing any available post-conviction relief.

Finally, the *White* standard begs for full factual litigation. Assuming that a petitioner has shown an omitted advisement, the trial court's work is not done as it was under *German/Austin*.[203] The court must still inquire as to whether the petitioner's plea would have reasonably changed. Further, assuming that the petitioner would testify in the affirmative in this regard, it is then incumbent upon the State to demonstrate the reasonableness of the position that the petitioner would not have changed the plea. This evidence, in the nature of rebuttal evidence, must be objective in nature and will probably center on the facts and circumstances of the plea agreement, the petitioner's prior involvement, if any, with the criminal justice system,[204] and the strength of the proof of the crime itself. None seems necessarily amenable to summary factual determination, and could lead to virtually a full trial on the crime charged. Though one must keep in mind the desire to provide for disposition on the merits, that goal of post-conviction relief statutes is not necessarily served by increasing the factual determinations needed for ultimate resolution. Increasing the litigable fact questions may also be a disservice to the goal of an expeditious procedure.

In summary, *White* does have an impact upon the post-conviction procedure as a whole, despite the fact that it is only changing the standard of appellate review. It imposes an additional pleading and proof requirement upon petitioners, causes an increase (at least for the present) in the number of post-conviction relief decisions which must be made and also opens up the possibility of much more involved factual determinations.[205]

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[203]*See supra* notes 72-84 and accompanying text.

[204]*See* Burns v. State, 500 N.E.2d 201 (Ind. 1986) (correct advisement in previous guilty plea hearing cured error of omitted advisement in case under review).

[205]One other effect of *White* upon the post-conviction process should be noted. In three cases in the survey period, appellate courts held that denial of post-conviction relief in a summary fashion was inappropriate when a public defender has been appointed to represent a petitioner but has not yet amended the *pro se* petition. Holliness v. State, 496 N.E.2d 1281 (Ind. 1986); Stoner v. State, 506 N.E.2d 837 (Ind. Ct. App. 1987); Colvin v. State, 501 N.E.2d 1149 (Ind. Ct. App. 1986). As noted in *Stoner*, "The rationale is a *pro se* petitioner seeking post-conviction relief is given leave to amend his petition as a matter of right by Indiana Rule of Post-Conviction Relief 1, § 4(c)." 506 N.E.2d at 838.

Under *White*, the court may look to the entire record to ascertain whether the plea was correctly accepted. 497 N.E.2d 893, 905. In determining if a petitioner would not

VI. Conclusion

White is susceptible to attack on numerous grounds, not the least of which is that it represents yet another change in guilty plea review. Beyond the difficulties of this fifth change in ten years which *White* creates, the case rests on faulty precedent and an ineffective refutation of *Austin* and *German*.

Nevertheless, *White* is the latest pronouncement in the area, and petitioners seeking to obtain relief under the *White* standard are left too little in the way of novel argument, and less in the way of meeting the standard itself. Post-conviction petitioners will likely be able to make gains only in the *Boykin* rights area, such as with *Henderson*, or in the area of pursuing a direct appeal. If this is truly the case, then one must hope that with these limited avenues for relief, the Indiana Supreme Court will, at minimum, leave *White* in place longer than its predecessors so that petitioners may pursue federally based rights without concern for vacillating state standards.

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have pleaded guilty, the court may look objectively at the record. *See* Granger v. State, 499 N.E.2d 743, 745 (Ind. 1986). These two items, when coupled with the post-conviction court's authority for summary disposition of the petitioner under Rule 1, § 4(f) of Indiana Rules of Procedure for Post-Conviction (*Remedies*), may cause an increase in the number of summary dispositions *without* action by the public defender's office because under *White*, the record alone may be a sufficient basis upon which to deny relief. The holdings of the three cases above may be, therefore, subject to new scrutiny and clarification in light of *White*.

Who Pays for Environmental Damage: Recent Developments in CERCLA Liability and Insurance Coverage Litigation

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I. Introduction

On October 17, 1986, the Superfund Amendments and Reauthorization Act of 1986 ("SARA") was signed into law as the first major revision of the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA").[1] Among other things, CERCLA established a fund (the "Superfund")[2] to be used for the cleanup of facilities[3] from which there have been a release[4] or a

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[1]CERCLA, Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified at 42 U.S.C.A. §§ 9601-0675 (Supp. 1987)).

[2]42 U.S.C.A. § 9611 (Supp. 1987).

[3]42 U.S.C.A. § 9601(9) (Supp. 1987):

> (9) The term "facility" means (A) any building, structure, installation, equipment, pipe or pipeline (including any pipe into a sewer or publicly owned treatment works), well, pit, pond, lagoon, impoundment, ditch, landfill, storage container, motor vehicle, rolling stock, or aircraft or (B) any site or area where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located; but does not include any consumer product in consumer use or any vessel.

[4]42 U.S.C.A. § 9601(22) (Supp. 1987):

> (22) The term "release" means any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment (including the abandonment or discarding of barrels, containers, and other closed receptacles containing any hazardous substance or pollutant or

threatened release of a hazardous substance[5] into the environment.[6] In addition, CERCLA authorized suits by the United States or by any other person to recover cleanup costs[7] from responsible par-

contaminant), but excludes (A) any release which results in exposure to persons solely within a work place, with respect to a claim which such persons may assert against the employer of such persons, (B) emissions from the engine exhaust of a motor vehicle, rolling stock, aircraft, vessel, or pipeline pumping station engine, (C) release of source, byproduct,or special nuclear material from a nuclear incident, as those terms are defined in the Atomic Energy Act of 1954 [42 U.S.C.A. § 2011 et seq.], if such release is subject to requirements with respect to financial protection established by the Nuclear Regulatory Commission under section 170 of such Act [42 U.S.C.A. § 2210], or, for the purposes of section 9604 of this title or any other response action, any release of source byproduct, or special nuclear material from any processing site designated under section 7912(a)(1) or 7942(a) of this title, and (D) the normal application of fertilizer.

[5]42 U.S.C.A. § 9601(14) (Supp. 1987):
(14) The term "hazardous substance" means (A) any substance designated pursuant to section 1321(b)(2)(A) of Title 33, (B) any element, compound, mixture, solution, or substance designated pursuant to section 9602 of this title, (C) any hazardous waste having the characteristics identified under or listed pursuant to section 3001 of the Solid Waste Disposal Act [42 U.S.C.A. § 6921] (but not including any waste the regulation of which under the Solid Waste Disposal Act [42 U.S.C.A. § 6901, et seq.] has been suspended by Act of Congress), (D) any toxic pollutant listed under section 1317(a) of Title 33, (E) any hazardous air pollutant listed under section 112 of the Clean Air Act [42 U.S.C.A. § 7412], and (F) any imminently hazardous chemical substance or mixture with respect to which the Administrator has taken action pursuant to section 2606 of Title 15. The term does not include petroleum, including crude oil or any fraction thereof which is not otherwise specifically listed or designated as a hazardous substance under subparagraphs (A) through (F) of this paragraph, and the term does not include natural gas, natural gas liquids, liquefied natural gas, or synthetic gas usable for fuel (or mixtures of natural gas and such synthetic gas).

[6]*See* 42 U.S.C.A § 9601(8) (Supp. 1987):
(8) The term "environment" means (A) the navigable waters, the waters of the contiguous zone, and the ocean waters of which the natural resources are under the exclusive management authority of the United States under the Magnuson Fishery Conservation and Management Act [16 U.S.C.A. § 1801 et seq.], and (B) any other surface water, ground water, drinking water supply, land surface or subsurface strata, or ambient air within the United States or under the jurisdiction of the United States.

[7]The costs and damages recoverable under 42 U.S.C.A. § 9607(a)(4) are:
(A) all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan; (B) any other necessary costs of response incurred by any other person consistent with the national contingency plan; (C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such a release;

ties.[8] CERCLA has already had a great impact in the State of Indiana as evidenced by the large number of sites that have been subject to CERCLA enforcement actions or that have or are involved in CERCLA settlement negotiations.[9] These sites are but a small fraction of the potential CERCLA sites as evidenced by the number of sites located within Indiana that are listed on the National Priorities List ("NPL").[10]

SARA does a great deal more than simply reauthorize CERCLA. For one thing, the new Superfund will contain $8.5 billion compared with $1.6 billion that Congress originally authorized for the Superfund.[11] SARA will also have the effect of making cleanups more expensive to undertake and possibly very much more expensive due to a variety of factors: standards contained in other federal environmental laws may operate as cleanup standards;[12] different and more stringent state stan-

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and (D) the costs of any health assessment or health effects study carried out under section 9604(i) of this title. 42 U.S.C.A. § 9607(a)(4). These amounts will be referred to hereafter as "environmental damages."

[8]42 U.S.C.A. § 9607(a) (1983); *see infra* note 9. Regarding private rights of action under CERCLA, see Belthoff, *Private Cost Recovery Actions Under Section 107 of CERCLA*, 11 Colum. J. Envtl. L. 141 (1986); Cross, *The Dimensions of a Private Right of Action Under Superfund*, 19 Conn. L. Rev. 193 (1987); Gaba, *Recovering Hazardous Waste Cleanup Costs: The Private Cause of Action Under CERCLA*, 13 Ecology L.Q. 181 (1986); Mauhs, *Judicial Limitations on the CERCLA Private Right of Action*, 15 Envtl. L. 471 (1985); Seng, *The Quasi-Contractual Nature of Cost-Recovery Actions Under CERCLA*, 5 Va. J. Nat. Resources L. 85 (1985); Note, *Private Right of Action to Recover Cleanup Costs from Superfund*, 49 Alb. L. Rev. 616 (1985); Note, *Private Cost Recovery Actions Under CERCLA*, 69 Minn. L. Rev. 1135 (1985); Note, *The Case Against Waste in Private Liability Actions Under CERCLA*, 60 N.Y.U.L. Rev. 888 (1985); Comment, *Private Response-Cost Recovery Actions Under CERCLA*, 34 U. Kan. L. Rev. 109 (1985).

[9]The Indiana Department of Environmental Management lists the following Superfund sites in Indiana (December 1986): Allen County—Fort Wayne Reduction; Bartholomew County—Tri State Plating, Old City Dump #1; Boone County—Environ-Chem (ECC), Northside Sanitary Landfill, Wedzeb Enterprises; Elkhart County—Main Street Well Field; Grant County—Marion Bragg Dump; Hamilton County—Firestone; Hancock County—Norman Poer Farm; Jackson County—Seymour Recycling Corp.; Knox County—Prestolite; Lake County—Lake Sandy Jo, (Martell) Ninth Avenue Dump, Midco I, Midco II, American Chemical Services; LaPorte County—Fisher Calo, Waste, Inc. (Dis-Pos-Al); Marion County—Reilly Tar and Chemical Corporation, Southside Landfill; Monroe County—Bennett Stone Quarry, Lemon Lane Landfill, Neal's Landfill; Owen County—Neal's Dump; St. Joseph County—Douglass Rd. Landfill; Vigo County—International Minerals and Chemical; Whitley County—Wayne Waste Oil.

[10]The National Priorities List, at 40 C.F.R. § 300 Appendix B (1986).

[11]Atkeson, Goldberg, Ellrad, III, & Connors, *An Annotated Legislative History of the Superfund Amendments and Reauthorization Act of 1986 (SARA)* in Superfund Deskbook 3 n. 24 (citing Conference Committee Report at 318, 320-21) Envtl. L. Inst. 1986) [hereinafter Superfund Deskbook].

[12]42 U.S.C.A. § 9621(d) (Supp. 1987).

dards may apply;[13] certain health assessments will be needed;[14] and most importantly, permanent cleanup solutions will be emphasized.[15] Even before the passage of SARA, the Environmental Protection Agency ("EPA") had a very strong hand in litigation against the potentially responsible parties and under SARA that hand has been strengthened considerably, by both institutionalizing some of EPA's enforcement and settlement policies into the statute and by giving the agency additional powers and protections.[16] It is also worth noting that the State of Indiana in the last legislative term adopted legislation that has been dubbed the state's "mini-Superfund."[17]

In light of the changes made to CERCLA by SARA, this article will explore two areas of the law that are important to practitioners in Indiana and their clients who may be involved in CERCLA litigation. The first section of this article will address the parties responsible for CERCLA response costs. The second section of the article will address the issues that arise between liability insurers and insureds as the insureds seek insurance coverage for CERCLA response costs.

II. CERCLA Liability Issues

The four classes of responsible parties (or "covered persons") from whom cleanup costs may be recovered are defined by section 107(a) of CERCLA.

> (1) The owner or operator of a vessel[18] or a facility;
> (2) Any person who, at the time of disposal of any hazardous substance, owned or operated any facility at which such hazardous substances were disposed of;
> (3) Any person who arranged for the disposal of hazardous substances at any vessel or facility owned by another person and containing such hazardous substances; and
> (4) Any person who accepted any hazardous substances for transport to sites selected by such person.[19]

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[13]42 U.S.C.A. § 9621(e) and (f) (Supp. 1987).

[14]42 U.S.C.A. § 9604(i)(6) (1983).

[15]42 U.S.C.A. § 9621(b) (Supp. 1987).

[16]Superfund Deskbook, *supra* note 11, at 3.

[17]Ind. Code §§ 13-7-8.7-1 to -6 (Supp. 1987).

[18]*See* 42 U.S.C.A. § 9601(28) (1983): (28) "The term 'vessel' means every description of watercraft or other artificial contrivance used, or capable of being used, as a means of transportation on water."

[19]42 U.S.C.A. § 9607(a) (1983) ("Section 107(a)"):

> Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section —(1) the owner and operator

Each covered person is jointly and severally liable[20] for all environmental damages at a site, unless he can prove by a preponderance of

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of a vessel or a facility, (2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of, (3) any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances, and (4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or threatened release which causes the incurrence of response costs, of a hazardous substance, shall be liable for — (A) all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan; (B) any other necessary costs of response incurred by any other person consistent with the national contingency plan; (C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such a release; and (D) the costs of any health assessment or health effects study carried out under section 9604(i) of this title. The amounts recoverable in an action under this section shall include interest on the amounts recoverable under subparagraphs (A) through (D). Such interest shall accrue from the later of (i) the date payment of a specified amount is demanded in writing, or (ii) the date of the expenditure concerned. The rate of interest on the outstanding unpaid balance of the amounts recoverable under this section shall be the same rate as is specified for interest on investments of the Hazardous Substance Superfund established under subchapter A of chapter 98 of Title 26. For purposes of applying such amendments to interest under this subsection, the term "comparable maturity" shall be determined with reference to the date on which interest accruing under this subsection commences.

[20]A covered person is jointly and severally liable for all environmental damages unless he can "prove that the environmental injury is divisible and there is a reasonable basis for apportioning the harm." United States v. Miami Drum Services, Inc., No. 85-0038, (S.D. Fla. Dec. 12, 1986); *see also* United States v. Bliss, No. 84-200(c)(1), slip op. (E.D. Mo. Aug. 7, 1987); United States v. Dickerson, 640 F. Supp. 448 (D. Md. 1986); State of Idaho v. Bunker Hill Co., 635 F. Supp. 665 (D. Idaho 1986); State of Colorado v. Asarco, Inc., 608 F. Supp. 1484 (D.C. Colo. 1985); United States v. Shell Oil Co., 605 F. Supp. 1064 (D.C. Colo. 1985); United States v. Conservation Chem. Co., 589 F. Supp. 59 (W.D. Mo. 1984); United States v. Northeastern Pharmaceutical and Chem. Co., 579 F. Supp. 823 (W.D. Mo. 1984); United States v. A&F Materials Co., Inc., 578 F. Supp. 1249 (S.D. Ill. 1984); United States v. Wade, 577 F. Supp. 1326 (E.D. Pa. 1983); United States v. Chem-Dyne Corp., 572 F. Supp. 802 (S.D. Ohio 1983); *see generally* Brennan, *Joint and Several Liability for Generators Under Superfund: A Federal Formula for Cost Recovery*, 5 UCLA. J. Envtl. L. & Pol'y 101 (1986); Price, *Dividing the Costs of Hazardous Waste Site Cleanups Under Superfund: Is Joint and Several Liability Appropriate?*, 52 U.M.K.C.L. Rev. 339 (1984); Note, *The Comprehensive Environmental Response, Compensation and Liability Act of 1980: Is Joint and Several Liability the Answer to Superfund?*, 18 New Eng. L. Rev. 109 (1982-83); Note, *Environmental Law — Joint*

the evidence that the environmental damages were caused solely by (1) an act of God; (2) an act of war; or (3) an act or omission of a third party.[21] Courts have unanimously concluded that the standard

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and Several Liability Under CERCLA, 57 Temple L.Q. 885 (1984); Note, *Joint and Several Liability Under Superfund*, 13 Loy. U. Chi. L.J. 489 (1982); Note, *Joint and Several Liability for Hazardous Waste Releases Under Superfund*, 68 Va. L. Rev. 1157 (1982); Casenote, *Joint and Several Liability Under Superfund: The Plight of the Small Volume Hazardous Waste Contributor*, 31 Wayne L. Rev. 1057 (1985).

[21]42 U.S.C.A. § 9607(b) (1983). The full text of § 9607(b) reads as follows:

> There shall be no liability under subsection (a) of this section for a person otherwise liable who can establish by a preponderance of the evidence that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by —(1) an act of God; (2) an act of war; (3) an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant (except where the sole contractual arrangement arises from a published tariff and acceptance for carriage by a common carrier by rail), if the defendant establishes by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions; or (4) any combination of the foregoing paragraphs.

It is currently unclear whether the *only* defenses available to a covered person are those set forth in section 107(b)(3). *See* 42 U.S.C.A. § 9607(a) (Supp. 1987) (imposing liability "subject only to the defenses set forth in subsection (b) of this section"); *see also* United States v. Tyson, 17 Envtl. L. Rep. (Envtl. L. Inst.) 20527, 20531 (E.D. Pa. 1986) ("Congress intended that responsible parties within the coverage of section 107(a) should be strictly liable subject only to the affirmative defenses relating to causation which are set forth in section 107(b)."); United States v. Ward, 618 F. Supp. 884, 897 (D.C.N.C. 1985) (strict liability under section 107(a) "is subject only to the defenses listed in section 107(b)"); United States v. Argent Corp., 14 Envtl. L. Rep. (Envtl. L. Inst.) 20616 (D.N.M. 1984). *But see* Mardan Corp. v. C.G.C. Music, Ltd., 600 F. Supp. 1049, 1056 n. 9 (D. Ariz. 1984):

> Because subsection (a) of Section 190 states that liability is "subject only to the defenses set forth in subsection (b) of this section," Mardan contends that the defenses listed in subsection (b) are exclusive. Mardan's argument does not withstand close analysis. As defendants have suggested, Mardan's interpretation would result in defendants being held liable even if they had already paid Mardan's Section 107(a) claim in a prior lawsuit since res judicata, payment, and accord and satisfaction are not listed as defenses in subsection (b). Similarly under Mardan's interpretation of the statute, defendants would not be able to raise such defenses as statute of limitations, waiver, laches, etc. For the foregoing reasons, the defenses listed in subsection (b) cannot be considered as exclusive.

See also United States v. Conservation Chem. Co., 619 F. Supp. 162, 204 (W.D. Mo. 1985) ("Equitable defenses are proper under CERCLA in determining liability, the nature of the remedy and the amount of damage").

of liability imposed under section 107(a) is strict liability.[22]

Although SARA did not directly amend section 107(a), its provisions have nevertheless had a major impact on the coverage of section 107(a). This section will address three areas in which SARA and judicial interpretation of CERCLA have had a major impact on liability under Section 107(a):[23] (1) the liability of owners of contaminated property; (2) the individual liability of corporate officers for acts by or on behalf of a corporation; and (3) the liability of creditors of covered persons. Finally, this section will apply the concepts developed in these areas to a consideration of potential liability under section 107(a) arising out of a trust's ownership of contaminated property.

A. Landowner Liability

Among the covered persons under section 107(a) are the current and former owners of contaminated property.[24] Former owners may be held

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[22]*See, e.g.*, J.V. Peters & Co. v. Administrator, 767 F.2d 263 (6th Cir. 1985); State of New York v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985); United States v. Miami Drum Services, Inc., No. 85-0038, slip op. (S.D. Fla. Dec. 12, 1986); United States v. Dickerson, 640 F. Supp. 448 (D. Md. 1986); *In re* T.P. Long Chemical, Inc., 45 B.R. 278 (Bankr. N.D. Ohio 1985); United States v. Conservation Chem. Co., 589 F. Supp. 59 (W.D. Mo. 1984); United States v. Northeastern Pharmaceutical and Chem. Corp., 579 F. Supp. 823 (W.D. Mo. 1984); United States v. Price, 577 F. Supp. 1103 (D.N.J. 1983); United States v. Ottati & Goss, Inc., 16 Envtl. L. Rep. (Envtl. L. Inst.) 20763 (D.N.H. 1985); United States v. Ward, 16 Envtl. L. Rep. (Envtl. L. Inst.) 20127 (E.D.N. C. 1985); United States v. Argent Corp., 14 Envtl. L. Rep. (Envtl. L. Inst.) 20616 (D.N.M. 1984); United States v. South Carolina Recycling and Disposal, Inc., 14 Envtl. L. Rep. (Envtl. L. Inst.) 20272 (D.S.C. 1984); United States v. Tyson, 17 Envtl. L. Rep. 20527 (E.D. Pa. 1986).

[23]Regarding liability under section 107(a), see generally Giblin, & Kelly, *Judicial Development of Standards of Liability in Governmental Enforcement Actions Under the Comprehensive Environmental Response, Compensation and Liability Act*, 33 Clev. St. L. Rev. 1 (1984); Hinds, *Liability Under Federal Law for Hazardous Waste Injuries*, 6 Harv. Envtl. L. Rev. 1 (1982); Lotz, *Liability Issues Under CERCLA*, 23 A.F. L. Rev. 370 (1982); Tripp, *Liability Issues in Litigation Under the Comprehensive Environmental Response, Compensation and Liability Act*, 52 U.M.K.C. L. Rev. 364 (1984); Warshauer & Stansel, *Analyzing the Relationship Between the Civil, Governmental, and Criminal Obligations and Liabilities for Hazardous Waste*, 22 Tort & Ins. L.J. 37 (1986); Comment, *Personal Liability for Hazardous Waste Cleanup: An Examination of CERCLA Section 107*, 13 B.C. Envtl. Aff. L. Rev. 643 (1986); Note, *CERCLA Defendants: The Problem of Expanding Liability and Diminishing Defenses*, 31 Wash. U.J. Urb. & Contemp. L. 289 (1987).

[24]*See generally* Levitas & Hughes, *Hazardous Waste Issues in Real Estate Transactions*, 38 Mercer L. Rev. 581 (1987); Moskowitz, & Hoyt, *Enforcement of CERCLA Against Innocent Owners of Property*, 19 Loy. L.A.L. Rev. 1171 (1986); Note, *Successor Landowner Suits for Recovery of Hazardous Waste Cleanup Costs: CERCLA Section 107(a)(4)*, 33 UCLA. L. Rev. 1737 (1986).

liable only if hazardous substances were disposed of at the property during their ownership.[25] Current owners may be liable even if no hazardous substances were disposed of at the property during their ownership.[26] In either case, liability is based solely upon ownership of the contaminated property, regardless of the landowner's lack of knowledge of or participation in any hazardous waste activity.[27]

This liability scheme can give rise to particularly harsh consequences when a landowner leases property to a tenant that engages in operations resulting in the release of a hazardous substance. The owner/lessor becomes a "covered person" and is strictly, jointly, and severally liable for all environmental damages resulting from the release.[28] The landowner could argue that, because the environmental damages were caused by the lessee's actions, the landowner should be entitled to rely on the third party defense of section 107(b)(3).[29] The third party defense is unavailable, however, if the third party was the landowner's employee or agent, or was one whose "act or omission occur[red] in connection with a contractual relationship, existing directly or indirectly, with the [landowner]."[30] The term "contractual relationship" includes the relationship

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[25]*See* 42 U.S.C.A. § 6907(a)(2) (Supp. 1987). Former owners who had actual knowledge that their property was contaminated may be subject to liability as a current owner if they transferred ownership without disclosing the property's contaminated condition. *See* 42 U.S.C.A. § 9601(35)(C)(Supp. 1987), which provides:

> (C) Nothing in this paragraph or in section 9607(b)(3) of this title shall diminish the liability of any previous owner or operator of such facility who would otherwise be liable under this chapter. Notwithstanding this paragraph, if the defendant obtained actual knowledge of the release or threatened release of a hazardous substance at such facility when the defendant owned the real property and then subsequently transferred ownership of the property to another person without disclosing such knowledge, such defendant shall be treated as liable under section 9607(a)(1) of this title and no defense under section 9607(b)(3) of this title shall be available to such defendant.

[26]*See* 42 U.S.C.A. § 9607(a)(1) (Supp. 1987); United States v. Tyson, 17 Envtl. L. Rep. (Envtl. L. Inst.) 20527, 20531 (E.D. Pa. 1986) ("The current owner of a facility is within section 9607(a)(1) even if it never operated the facility as a hazardous waste dump site and even if no hazardous wastes were dumped at the facility during its period of ownership."); *see also* cases cited in Superfund Deskbook, *supra* note 11.

[27]*See, e.g.*, United States v. Cauffman, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20161 (C.D. Cal. 1984).

[28]*See, e.g.*, United States v. Cauffman, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20161 (C.D. Cal. 1984); United States v. Argent Corp., 14 Envtl. L. Rep. (Envtl. L. Inst.) 20616 (D.N.M. 1984); United States v. South Carolina Recycling and Disposal, Inc., No. 80-1274-6, slip op. (D.S.C. Aug. 28, 1984) (sublessor may also be an "owner" under 107(a)(1)). The lessee will also be liable under 107(a)(1) as an "operator."

[29]*See* 42 U.S.C.A. § 9607(b)(3) (1983).

[30]42 U.S.C.A. § 9607(b)(3) (1983).

between lessor and lessee,[31] and the owner/lessor is therefore barred from this defense.

The term "contractual relationship" also includes the relationship between the purchaser and seller of contaminated property.[32] Prior to SARA, it was therefore possible that an innocent purchaser of real estate might become subject to liability for environmental damages under CERCLA. SARA has ameliorated this harsh result. It is now clear that an "innocent" landowner—one whose only connection to his property's contamination is his deed to the contaminated property—is not liable under CERCLA. To establish his "innocence," the landowner must prove by a preponderance of the evidence: (1) that he acquired the property after it became contaminated, (2) that at the time he acquired the property, he had no reason to know that any hazardous substance contaminated the property, (3) that the landowner "is a government entity which acquired the [property] by escheat, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation, [or] (4) [that the landowner] acquired the property by inheritance or bequest."[33]

The landowner must also prove that he exercised due care with respect to the hazardous substance concerned and that he took precautions against the foreseeable acts or omissions of third parties and the consequences that could foreseeably result from such acts or omissions.[34]

Although SARA now protects an "innocent" landowner from liability under section 107(a), a purchaser may not become an innocent landowner by remaining deliberately ignorant of the acquired property's contamination. A purchaser cannot claim that he had "no reason to know" that the property was contaminated unless he can establish by a preponderance of the evidence that, at the time he acquired the property, he made "all appropriate [inquiries] into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability."[35]

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[31]*See* 42 U.S.C.A. § 9601(35)(A) (Supp. 1987), which provides in relevant part that "[t]he term 'contractual relationship', for the purpose of section 9607(b)(3), includes, but is not limited to, land contracts, deeds, or other instruments transferring title or possession . . . ." *See also* United States v. Argent Corp., 14 Envtl. L. Rep. (Envtl. L. Inst.) 20616 (D.N.M. 1984).

[32]*See supra* note 31.

[33]42 U.S.C.A. § 9601(35)(A) (Supp. 1987). The Conference Report on SARA explains, however, that one who inherits property with actual knowledge of its contamination may not rely on the innocent landowner defense. *See* H.R. Conf. Rep. No. 962, 99th Cong., 2d Sess. 187 (1986).

[34]42 U.S.C.A. § 9601(35)(A) (Supp. 1987), 9607(b)(3)(a), 9607(b)(3)(b) (1982).

[35]42 U.S.C.A. § 9601(35)(B) (Supp. 1987).

> For purposes of the preceding sentence, the court shall take into account any specialized knowledge or experience on the part of the defendant, the relationship of the purchase price to the value of the property if uncontaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property, and the ability to detect such contamination by appropriate inspection.[36]

The conference report on SARA provides some helpful guidance regarding the nature of the inquiry required to become an innocent landowner.[37]First, the duty to inquire "shall be judged as of the time of acquisition."[38] Second, landowners "shall be held to a higher standard as public awareness of the hazards associated with hazardous substance releases has grown."[39] Third, landowners engaged in commercial transactions will "be held to a higher standard than those who are engaged in private residential transactions."[40] Fourth, property heirs and devisees have a duty to inquire, but the standard of inquiry is lower than for those engaged in private transactions. Also, heirs who acquire property without knowledge of the inheritance have no duty to inquire.[41]

B. *The Corporate Context*

A number of courts have held corporate officers individually liable under section 107(a) for environmental damages resulting from acts by or on behalf of a corporation. In such cases, the individual defendants have been held personally liable based upon the nature and extent of their involvement with the corporation's hazardous waste activities. Consequently, such cases are highly fact specific.

In *United States v. Northeastern Pharmaceutical & Chemical Co.* ("NEPACCO"),[42] the Eighth Circuit Court of Appeals found NEPACCO's president ("Michaels") and vice president ("Lee") individually liable under Section 107(a)(3), which imposes liability on "any person"[43]

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[36]*Id.*

[37]Joint Explanatory Statement of the Committee of Conference, Conference Report 99-962, p. 187.

[38]*Id.*

[39]*Id.*

[40]*Id.*

[41]*Id.*

[42]810 F.2d 726 (8th Cir. 1986).

[43]*See* 42 U.S.C.A. § 9601(21) (Supp. 1987): (21) "The term 'person' means an individual, firm, corporation, association, partnership, consortium, joint venture, commercial entity, United States Government, State, municipality, commission, political subdivision of a State, or any interstate body."

who arranges for the disposal of hazardous substances.[44] NEPACCO arose out of the Company's disposal of hazardous wastes at a site known as the "Denny farm." Lee, as vice president and a major shareholder of the Company, was directly responsible for arranging the disposal of the Company's hazardous wastes, assisting in the selection of the Denny farm site, and supervising the Company's contract with the operator of the site. Michaels was the Company's founder, president, and a major stockholder, and had the capacity and responsibility to control the Company's hazardous waste activities, to direct negotiations concerning waste disposal, and to prevent and abate the damage resulting from the Company's hazardous waste activities.[45] Noting that "the term 'person' includes both individuals and corporations and does not exclude corporate officers or employees,"[46] the court rejected the individual defendants' argument that they could not be held individually liable because they had acted solely as corporate officers on NEPACCO's behalf:

> Lee argues that he cannot be held individually liable for NEPACCO's wrongful conduct because he acted solely as a corporate officer or employee on behalf of NEPACCO. The liability imposed upon Lee, however, was not derivative but personal. Liability was not premised solely upon Lee's status as a corporate officer or employee. Rather, Lee is individually liable under CERCLA §107(a)(3), 42 U.S.C. §9607(a)(3), because he personally arranged for the transportation and disposal of hazardous substances on behalf of NEPACCO and thus actually participated in NEPACCO's CERCLA violations.[47]

The court also held that the individual defendants could be held liable without regard to whether it would be appropriate to pierce the corporate veil:

> Lee can be held individually liable because he personally participated in conduct that violated CERCLA; this personal liability is distinct from the derivative liability that results from "piercing the corporate veil." "The effect of piercing a corporate veil is to hold the owner of the corporation liable. The rationale for piercing the corporate veil is that the corporation is something less than a bona fide independent entity." . . . Here, Lee is liable because he personally participated in the wrongful conduct

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[44] *See* 42 U.S.C.A. § 9607(a)(3) (Supp. 1987).
[45] *NEPACCO*, 810 F.2d 726.
[46] *Id.* at 744.
[47] *Id.*

> and not because he is one of the owners of what may have been a less than bona fide corporation.[48]

Finally, the court also found that, for purposes of section 107(a)(3), it was irrelevant that the individual defendants did not own or possess the hazardous substances disposed at the Denny farm site:

> It is the authority to control the handling and disposal of hazardous substances that is critical under the statutory scheme. The district court found that Lee, as plant supervisor, actually knew about, had immediate supervision over, and was directly responsible for arranging for the transportation and disposal of the NEPACCO plant's hazardous substances at the Denny farm site. We believe requiring proof of personal ownership or actual physical possession of hazardous substances as a precondition for liability under CERCLA Section 107(a)(3), 42 U.S.C. §9607(a)(3), would be inconsistent with the broad remedial purposes of CERCLA.[49]

In *United States v. Conservation Chemical Co.*,[50] a district court in Missouri held the Company's president and majority stockholder ("Hjersted") individually liable under sections 107(a)(1) and (2). Hjersted was the Company's founder, and president, and at all times owned at least ninety-three percent (93%) of its stock. In addition, Hjersted, acting as a chemical engineer and the Company's sole "technical person," was primarily responsible for the Company's environmental controls. Finally, Hjersted controlled the Company's fiscal matters and was closely involved in the Company's day-to-day operations.

The court analyzed the concept of "owner or operator"[51] and concluded that "a person who owns an interest in the facility and is actively

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[48]*Id.* (citations omitted).

[49]*Id.*

[50]628 F. Supp. 391 (W.D. Mo. 1985).

[51]*See* 42 U.S.C.A. § 9601(20) (Supp. 1987):

(20)(A) The term "owner or operator" means (i) in the case of a vessel, any person owning, operating, or chartering by demise, such vessel, (ii) in the case of an on shore facility or an offshore facility, any person owning or operating such facility, and (iii) in the case of any facility, title or control of which was conveyed due to bankruptcy, foreclosure, tax delinquency, abandonment, or similar means to a unit of State or local government, any person who owned, operated, or otherwise controlled activities at such facility immediately beforehand. (B) In the case of a hazardous substance which has been accepted for transportation by a common or contract carrier and except as provided in section 9607(a)(3) or (4) of this title, (i) the term "owner or operator" shall mean such common carrier or other bona fide for hire carrier acting as an independent contractor during such transportation, (ii) the shipper of such hazardous substance

participating in its management can be held liable for the disposal of hazardous waste."[52] Based upon Hjersted's "high degree of personal involvement in the [company's] operation and decision-making process,"[53] the court found him individually liable.

In *State v. Shore Realty Corp.*,[54] the Second Circuit Court of Appeals held the defendant corporation's majority shareholder and chief executive officer ("LeoGrande") individually liable as an owner or operator under Section 107(a). *Shore Realty Corp.* resulted from extensive contamination at a hazardous waste disposal facility owned and operated by the defendant corporation. The court found that LeoGrande had incorporated the corporation solely for the purpose of purchasing the contaminated property and that "[a]ll corporate decisions and actions were made, directed, and controlled by him."[55] The court rejected LeoGrande's argument that he could not be held individually liable without piercing the corporate veil and concluded that "an owning stockholder who manages the corporation, such as LeoGrande, is liable under CERCLA as an 'owner or operator'."[56]

In *State v. Bunker Hill*,[57] a district court in Idaho relied upon similar principles in holding a parent corporation liable as an owner or operator of its subsidiary's facility. Although the court cautioned that "care must be taken so that 'normal' activities of a parent with respect to its

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shall not be considered to have caused or contributed to any release during such transportation which resulted solely from circumstances or conditions beyond his control. (C) In the case of a hazardous substance which has been delivered by a common or contract carrier to a disposal or treatment facility and except as provided in section 9607(a)(3) or (4) of this title (i) the term "owner or operator" shall not include such common or contract carrier, and (ii) such common or contract carrier shall not be considered to have caused or contributed to any release at such disposal or treatment facility resulting from circumstances or conditions beyond its control. (D) The term "owner or operator" does not include a unit of State or local government which acquired ownership or control involuntarily through bankruptcy, tax delinquency, abandonment, or other circumstances in which the government involuntarily acquires title by virtue of its function as sovereign. The exclusion provided under this paragraph shall not apply to any State or local government which has caused or contributed to the release or threatened release of a hazardous substance from the facility, and such a State or local government shall be subject to the provisions of this chapter in the same manner and to the same extent, both procedurally—and substantively,—as any nongovernmental entity, including liability under section 9607 of this title.

[52]628 F. Supp. at 418.

[53]*Id.* at 420.

[54]759 F.2d 1032 (2d Cir. 1985).

[55]*Id.* at 1038.

[56]*Id.* at 1052.

[57]635 F. Supp. 665 (D. Idaho 1986).

subsidiary do not automatically warrant finding the parent an owner or operator,"[58] the court rejected the parent's contention that only the subsidiary, and not the parent, could be an owner and operator of the facility:

> Defendant Gulf was in a position to be, and was, intimately familiar with hazardous waste disposal and releases at the Bunker Hill facility; had the capacity to control such disposal and releases; and had the capacity, if not total reserved authority, to make decisions and implement actions and mechanisms to prevent and abate the damage caused by the disposal and releases of hazardous wastes at the facility. As noted previously in this opinion, approval from Gulf was necessary before more than Five Hundred Dollars ($500) could be spent on pollution matters and before capital expenditures could be made. Gulf at times controlled a majority of Bunker Hill's board of directors and Gulf obtained weekly reports of day-to-day aspects of Bunker Hill operations. With respect to Congress' intent that those who bore the fruits must also bear the burdens of hazardous waste disposal, it must be noted that Bunker Hill's authorized capital was a mere Eleven Hundred Dollars ($1100) while Gulf received Twenty-Seven Million Dollars ($27,000,000) in dividends from Bunker Hill. Gulf fully owned Bunker Hill.
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> The court finds that the evidence presented is sufficient to impose liability on Gulf as an owner or operator for purposes of Section 107(a)(2), 42 U.S.C.A. § 9607(a)(2).[59]

Despite the fact specific nature of these cases, certain consistent themes have emerged. First, courts have consistently upheld the principle that corporate officers may be held individually liable if they exercise sufficient control over corporate activities.[60] The decided cases, however,

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[58]*Id.* at 672.

[59]*Id*

[60]*See* cases cited and accompanying text *supra* notes 42-59. *See also* United States v. Ward, 618 F. Supp. 884, 894 (E.D.N.C. 1985) ("A corporate officer of a company who exercises authority for the company's operations and participates in arranging for the disposal of hazardous wastes is liable under 107(a)(3) for cleanup costs."); United States v. Mottolo, 605 F. Supp. 898 (D.N.H. 1985) (individual defendant who was president, treasurer, and sole shareholder of corporation may be held individually liable under CERCLA 107(a)(3) without piercing corporate veil); United States v. Carolawn, 14 Envtl. L. Rep. (Envtl. L. Inst.) 20699, 20700 (D.S.C. 1984) ("[T]o the extent that an individual has control or authority over the activities of a facility from which hazardous substances are released or participates in the management of such a facility, he may be held liable for response costs incurred at the facility, notwithstanding the corporate character of the business."). *But see* United States v. Wade, 577 F. Supp. 1326 (E.D. Pa. 1983) (insufficient evidence to hold president of corporation individually liable under CERCLA 107(a)(4)).

have all involved individuals who were shareholders and officers in close corporations, and were, therefore, extensively involved in day-to-day corporate management. However, individual liability should not be imposed upon the executive officers of a major publicly held corporation, since such officers would lack the intimate knowledge and operational control possessed by the officers of a close corporation.

Second, courts have interpreted CERCLA to impose liability for cleanup upon those who benefit from the activities which result in contamination.[61] It is clear that the shareholder-officers of a closely held corporation benefit in a direct and immediate way from the corporation's activities, but it is far less clear that the shareholder-officers of a major, publicly held corporation benefit analogously. This distinction militates against the imposition of liability upon shareholder-officers in publicly held corporations, to the extent that the shareholder-officers do not actually participate in hazardous waste activities.

Third, individual liability has consistently been premised more upon operational control than upon ownership. Although the corporate officers thus far held liable have all been shareholders, the courts have focused upon the individuals' operational control of corporate decision-making to a far greater extent than upon their ownership interest.[62] This point is underscored by the fact that courts have imposed liability without regard to the propriety of piercing the corporate veil.

Finally, courts will likely employ a similar analysis to impose liability upon parent corporations for their subsidiaries' waste management practices. If a parent corporation becomes too entangled with its subsidiary's activities, the parent will likely be deemed an owner or operator under Section 107(a).

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[61]*See* United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20994, 20995 (E.D. Pa. 1985) (citing Congressional "intent to impose cleanup costs on those who bore the fruits of hazardous waste disposal and who were involved in the planning and implementation of the disposal practices"); United States v. Shell Oil Co., 605 F. Supp. 1064, 1072 (D. Colo. 1985) (quoting S. Rep. No. 96-848, 96th Cong., 2d Sess. at 98 (1980)):

> [S]ociety should not bear the costs of protecting the public from hazards produced in the past by a generator, transporter, consumer, or dumpsite owner or operator who has profited or otherwise benefited from commerce involving these substances and now wishes to be insulated from any continuing responsibilities for the present hazards to society that have been created.

See also United States v. Northeastern Pharmaceutical and Chem. Co., 579 F. Supp. 823, 848 (1984) ("Congress has determined that the persons who bore the fruits of hazardous waste disposal also bear the costs of cleaning it up.").

[62]Apparently, no reported decision has based individual liability under 107(a) solely on an individual's ownership of stock.

C. Lender Liability

A secured creditor of a covered person may also become subject to liability under Section 107(a).[63] The statutory definition of "owner or operator" provides a limited exemption from liability for a secured creditor:

> "Owner or operator" means . . . (ii) in the case of an on shore facility or an offshore facility, any person owning or operating such facility . . . . *Such term does not include a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility.*[64]

In *United States v. Mirabile*,[65] a Pennsylvania district court held that American Bank and Trust Company ("AB&T") was not liable under Section 107(a) for the cleanup of property subject to AB&T's mortgage. In *Mirabile*, AB&T advanced a loan to Turco Coatings, Inc. ("Turco"), which operated a paint manufacturing facility (the "Turco facility"), and secured the loan with a mortgage on the Turco facility. When Turco defaulted on the loan, AB&T foreclosed on its mortgage and was highest bidder at the resulting foreclosure sale. Before AB&T took legal title to the Turco facility, however, AB&T assigned its bid to the defendant Mirabile, who accepted a deed to the property. When the Turco facility was subsequently found to be contaminated, the United States sued Mirabile under CERCLA to recover its response costs. In turn, Mirabile joined AB&T as a third party defendant.

The *Mirabile* court considered the secured creditor exemption and concluded:

> [T]he exemption plainly suggests that provided a secured creditor does not become overly entangled in the affairs of the actual owner or operator of a facility, the creditor may not be held liable for cleanup costs. The difficulty arises, of course, in determining how far a secured creditor may go in protecting its

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[63]Regarding lender liability under CERCLA, see Burcat, *Environmental Liability of Creditors Under Superfund*, 33 (No. 2) PRAC. LAW. 13 (1987); Burcat, *Environmental Liability of Creditors: Open Season on Banks, Creditors, and Other Deep Pockets*, 103 BANKING L.J. 509 (1986); Murphy, *The Impact of "Superfund" and other Environmental Statutes on Commercial Lending and Investment Activities*, 41 BUS. LAW. 1133 (1986); Vollman, *Double Jeopardy: Lender Liability Under Superfund*, 16 REAL EST. L.J. 3 (1987); Comment, *The Impact of the 1986 Superfund Amendments and Reauthorization Act on the Commercial Lending Industry: A Critical Assessment*, 41 U. MIAMI L. REV. 879 (1987).

[64]42 U.S.C.A. § 9601(20)(A) (Supp. 1987).

[65]15 Envtl. L. Rep. (Envtl. L. Inst.) 20994 (E.D. Pa. 1985).

> financial interests before it can be said to have acted as an owner or operator within the meaning of the statute.[66]

The court noted that other decisions had addressed the individual liability of corporate officers under Section 107(a),[67]but concluded that these decisions were inapplicable because they involved defendants who were intimately involved in the management of closely held corporations. Corporate officers in a closely held corporation actively participated in the day-to-day operations of the corporation's business. In *Mirabile*, the secured creditor's participation in the corporation's business was limited to financial decisions. The court considered this distinction important[68] and stated: "The participation which is critical is participation in operational, production, or waste disposal activities. Mere financial ability to control waste disposal practices of the sort possessed by the secured creditors in this case is [insufficient to impose liability]."[69] Because AB&T had not participated in the day-to-day operation of the Turco facility, the court held AB&T not liable as an owner or operator under Section 107(a).[70]

In *United States v. Maryland Bank & Trust Co.*,[71] the court reached the opposite conclusion, based upon a slightly different set of facts and a different reading of the secured creditor exemption. In *Maryland Bank & Trust*, the debtor owned and operated a waste disposal facility in California, Maryland (the "CMD site"). Maryland Bank & Trust Company ("MB&T") advanced a loan to the debtor to purchase the CMD site, and secured the loan with a mortgage on the site. When the debtor defaulted on the loan, MB&T instituted a foreclosure action, purchased the property at a foreclosure sale, and took title to the property. Four years later, the site was discovered to be contaminated by hazardous wastes disposed of prior to MB&T's ownership. EPA then brought suit against MB&T to recover its CERCLA response costs.[72]

The court rejected MB&T's contention that it was exempted from liability by the secured creditors exemption, and distinguished *Mirabile* by noting that MB&T had actually taken title to the property and had held title for more than four years, whereas in *Mirabile* the bank took

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[66]*Id.* at 20995.

[67]*See supra* notes 42-56 and accompanying text.

[68]15 Envtl. L. Rep. (Envtl. L. Inst.) at 20995.

[69]*Id.*

[70]The Mirabile court noted that its ruling was: limited to financial institutions which provide funds to entities which dispose of hazardous waste as a result of their business operations. It may be that a different test would be appropriate for financiers of entities whose sole business is that of hazardous waste disposal.

[71]632 F. Supp. 573 (D. Md. 1986).

[72]*Id.*

only equitable title and reconveyed the property after only four months. More importantly, however, the *Maryland Bank & Trust* court took a different view of the secured creditor exemption than did the *Mirabile* court. The *Maryland Bank & Trust* court concluded that the exemption does not protect creditors who take legal title to contaminated property:

> MB&T purchased the property at the foreclosure sale not to protect its security interest, but to protect its investment. Only during the life of the mortgage did MB&T hold indicia of ownership primarily to protect its security interest in the land. Under the law of Maryland (and twelve other states), the mortgagee financial institution actually holds title to the property while the mortgage is in force . . . . Congress intended by this exception to exclude these common law title mortgagees from the definition of "owner" since title was in their hands only by operation of the common law. The exclusion does not apply to former mortgagees currently holding title after purchasing the property at a foreclosure sale, at least when, as here, the former mortgagee has held title for nearly four years, and a full year before the EPA clean-up.[73]

The court also based its decision upon the policy underlying CERCLA:

> The interpretation of Section 101(20)(A) urged upon the court by MB&T runs counter to the policies underlying CERCLA. Under the scenario put forward by the bank, the federal government alone would shoulder the cost of cleaning up the site, while the former mortgagee-turned-owner, would benefit from the clean-up by the increased value of the now unpolluted land. At the foreclosure sale, the mortgagee could acquire the property cheaply. All other prospective purchasers would be faced with potential CERCLA liability, and would shy away from the sale. Yet once the property has been cleared at the taxpayers expense and becomes marketable, the mortgagee-turned-owner would be in a position to sell the site at a profit. In essence, the defendant's position would convert CERCLA into an insurance scheme for financial institutions, protecting them against possible losses due to the security of loans with polluted properties. Mortgagees, however, already have the means to protect themselves, by making prudent loans. Financial institutions are in a position to investigate and discover potential problems in their secured properties. For many lending institutions, such

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[73] *Id.* at 579 (citations omitted).

research is routine. CERCLA will not absolve them from responsibility for their mistakes of judgment.[74]

In summary, two clear themes emerge from an analysis of *Mirabile* and *Maryland Bank & Trust.* First, a secured creditor may become subject to liability as an owner or operator if it involves itself in the debtor's operations. This conclusion is consistent with an underlying theme of CERCLA that liability be imposed upon those with operational control of hazardous waste activities.[75]

Second, a lender that takes actual title to contaminated property (e.g., through a foreclosure sale) may become subject to liability as an owner. This conclusion is consistent with the apparent purpose of the secured creditor exemption,[76] and is also consistent with an underlying theme of CERCLA that those who benefit from hazardous waste activities should also bear the burden.[77] Lenders would therefore be wise to undertake a commercially reasonable investigation before taking title to potentially contaminated collateral.[78]

D. *Potential Section 107(a) Liability of Trustees and Beneficiaries*

Some interesting issues arise when the foregoing principles are applied to the potential CERCLA liability of parties to a trust. Assume, for example, that Settlor establishes an inter vivos trust[79] on behalf of Beneficiary and that the corpus of the trust consists of commercial real estate. Assume further that Settlor appoints Trustee to manage the trust on Beneficiary's behalf and that Beneficiary is to receive income from the trust until he reaches twenty-one (21) years of age, at which time he is to receive legal title to the trust property. Finally, assume that after the trust is established but before Beneficiary takes legal title, the property is discovered to be contaminated as a result of the disposal of hazardous wastes prior to the establishment of the trust. Who is responsible for cleanup of the property: Settlor, Trustee, Beneficiary, all three of them, or none of them?

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[74]*Id.* at 580.

[75]*See* United States v. Northeastern Pharmaceutical and Chem. Co., 579 F. Supp. 823, 848 (W.D. Mo. 1984)(CERCLA was designed to insure, so far as possible, that the parties responsible for the creation of hazardous waste sites be liable for the response costs in cleaning them up."); *cf. supra* notes 42-62 and accompanying text.

[76]*See supra* note 64 and accompanying text.

[77]*See supra* note 61 and accompanying text.

[78]*See supra* notes 35-41 and accompanying text.

[79]For a discussion of various aspects of inter vivos trusts, see 1 W. Fratcher, Scott on Trusts §§ 19, 31, 32 (4th ed. 1987).

Settlor no longer holds any legal or equitable interest in the property.[80] Assuming that Settlor is not currently involved in the operation of the property or the disposal of hazardous waste at the property, Settlor could be liable only as a former owner of the property.[81] Settlor's liability would therefore depend upon whether hazardous wastes were disposed of at the property during his ownership[82] and, if so, whether he could establish an innocent landowner defense.[83]

Trustee has legal title to the property[84] and the authority to exercise control over its disposition and use.[85] However, Trustee holds legal title only to enable him to manage the property on Beneficiary's behalf, and

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[80]The analyses of Settlor's potential liability would likely follow a different path if the Settlor retained some equitable interest in the trust property or the power to revoke the trust. In such a case Settlor might well be found to be a current owner or operator. For example, in United States v. Carolawn, 14 Envtl. L. Rep. (Envtl. L. Inst.) 20698 (D.S.C. 1984), the court denied a defendant corporation's motion for summary judgment on the issue of its liability as an owner or operator under 107(a). The corporation obtained title to contaminated property from a trustee-in-bankruptcy and almost simultaneously transferred title to three individual defendants. The court rejected the corporation's contention that it was nothing more than a conduit in the transfer of title:

> The facts regarding the transfer of title to the Fort Lawn property and the degree of COCC's continuing interest and control are somewhat cloudy. This Court certainly cannot say that, based on the record presently before it, there is no room for controversy and that the government could not prevail under any circumstances . . . Possession of title, or the lack thereof, is not necessarily dispositive with respect to the questions of ownership or control. "While a certificate of title is an indicium of ownership, and may establish the person entitled to possession, such a certificate is not conclusive evidence of ownership." Justice v. Fabey, 541 F.Supp. 1019, 1023 n.4 (E.D. Pa. 1982) (citations omitted); *see also* Hemme v. Stein, 218 P. 853 (Okla. 1923) ("Title and rights in real property may not always be as appears by the record." Id. at 854.) Thus, at the very least, further inquiry concerning whether COCC retained a legal or equitable interest in the property after the transfer is necessary before the court can determine whether COCC is liable under CERCLA Section 107(a) as an owner of the Fort Lawn site.

Id. at 20698-99. For a discussion of settlor as beneficiary, see 2 W. Fratcher, Scott on Trusts § 114 (4th ed. 1987). For a discussion of a settlor's power to modify or terminate a trust, see 4 A. Scott, Scott on Trusts §§ 330, 331 (3d ed. 1967).

[81]*See* 42 U.S.C.A. § 9607(a)(2) (Supp. 1987). If Settlor had previously generated wastes disposed at the property, arranged for disposal of wastes at the property or transported wastes to the property for disposal, Settlor might also be subject to liability. *See* 42 U.S.C.A. § 9607(a)(2), (3) (Supp. 1987).

[82]*See* 42 U.S.C.A. § 9607(a)(2) (Supp. 1987).

[83]*See supra* notes 35-41 and accompanying text.

[84]*See* 1 W. Fratcher, Scott on Trusts § 2.6 (4th ed. 1987) ("A trust is created only where title to property is held by one person for the benefit of another.").

[85]For a discussion of a trustee's powers and duties with respect to the administration of a trust, see 2A W. Fratcher, Scott on Trusts §§ 163A-185 (4th ed. 1987); 3 A. Scott, Scott on Trusts §§ 185A-196 (3d ed. 1967 and 1985 Supp.).

it is not at all clear that Trustee benefits in any meaningful way from "ownership" of the property.[86] Beneficiary is the beneficial owner of the property[87] and, as between Trustee and Beneficiary, is clearly the party who benefits from ownership. On the other hand, Beneficiary may have no authority whatever to control the disposition or use of the property before he takes legal title.

Neither Beneficiary nor Trustee fits neatly into the owner or operator pigeonhole; each has good arguments that the other should be responsible. However, a facility can clearly have more than one owner or operator under CERCLA.[88] Therefore, a court might resolve this apparent conflict by holding Trustee and Beneficiary liable.[89]

Trustee may be able to escape liability by asserting the third party defense of Section 107(b)(3).[90] This defense may prove successful with respect to the third parties responsible for contamination of the property, because Trustee would presumably have no contractual relationship with them.[91] It may not prove successful with respect to Settlor, however, because Trustee may be deemed to have a contractual relationship with Settlor by virtue of the trust agreement.[92] With respect to Settlor, therefore, Trustee might be barred from the third party defense unless he undertook a commercially reasonable investigation before he accepted title to the property as Trustee.[93]

Beneficiary might also escape liability by asserting the third party defense. Beneficiary could argue that the contamination was caused solely by Settlor, Trustee, or other parties with whom Beneficiary had no contractual relationship. On the other hand, it could be argued that Beneficiary does stand in a contractual relationship with both Settlor

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[86]*See supra* note 82 (A trustee may receive compensation for his services). *See* 3 A. Scott, Scott on Trusts § 242 (3d ed. 1967). It is not at all clear, however, that such a "benefit" is in any way meaningful for purposes of CERCLA. *Cf. supra* notes 50-53 and accompanying text.

[87]For a general discussion of trust beneficiaries and their interest in trust property, see 2 W. Fratcher, Scott on Trusts §§ 112-131 (4th ed. 1987). A beneficiary's equitable interest may cause a beneficiary to be deemed an owner or operator. *Cf. supra* note 77.

[88]*See, e.g.*, United States v. South Carolina Recycling and Disposal, Inc., No. 80-1274-6, slip op. (D.S.C. Aug. 28, 1984) (both property owner and lessee who subleased property deemed "owners" under 107(a)).

[89]*Cf.* United States v. Price, 577 F. Supp. 1103, 1109 (D.N.J. 1983) ("[T]he liability provisions are of no help if 'a financially responsible owner of the site cannot be located'").

[90]42 U.S.C.A. § 9607(b)(3) (1983).

[91]*See id.*

[92]Regarding a trustee's duty to comply with the terms of a trust, see 2A W. Fratcher, Scott on Trusts § 164.1 (4th ed. 1987). Regarding the requirement of a written memorandum, see 1 W. Fratcher, Scott on Trusts §§ 38-52.1 (4th ed. 1987).

[93]*See supra* notes 36-41 and accompanying text. Regarding a trustee's right to disclaim, see 1 W. Fratcher, Scott on Trusts § 35 (4th ed. 1987).

and Trustee as a third party beneficiary of the trust agreement.[94] If so, Beneficiary would be barred from the third party defense unless he conducted an investigation of the property before accepting his inheritance.[95]

A court might seek to mitigate these harsh results by limiting a Section 107(a) recovery to the value of the trust assets, but it is unclear how such a principle would be derived from CERCLA. Since contaminated property might be completely valueless, this principle could deny Section 107(a) plaintiffs any recovery at all. Finally, such a limitation on liability would create a powerful incentive for covered persons to place contaminated property in trust, in order to shield themselves from liability.

As this example makes clear, fundamental concepts in CERCLA remain ill-defined, and CERCLA's application is problematic outside the paradigm cases apparently contemplated by Congress. The uncertainties inherent in Section 107(a) will certainly provoke further litigation before any clear answers develop.

III. Insurance Coverage for Environmental Cleanups

A. *Introduction*

CERCLA remedial actions and cleanups often impose large and unexpected cost responsibilities on private parties. Increasingly, "potentially responsible parties" ("PRPs") have looked to their general liability insurers to obtain coverage for CERCLA claims. Businesses typically seek to invoke the insurer's obligation to defend[96] and to indemnify for

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[94]*But see* 1 W. Fratcher, Scott on Trusts §14 (4th ed. 1987) (distinguishing trust and contract for benefit of third party).

[95]Regarding a beneficiary's right to disclaim, see *id.* at 36.

[96]This article will not address the insurer's "duty to defend," which is the obligation to the insured to provide an attorney or attorneys' fees and reimbursement of other costs associated with the defense of actions that are or may be covered by a liability insurance policy. The majority of jurisdictions hold that the duty to defend an insured is broader than the duty to indemnify the insured for amounts paid in judgment or settlement of an action. As one court has stated:

> [It] is crystal clear that the insurer's duty to defend is separate and distinct from the duty to indemnify. The duty to defend is contractual and one that is heavier and broader than the duty to indemnify. The obligation to defend has been deemed "litigation insurance" as well as "liability insurance." Thus the insurer is required to provide a defense to any action, however groundless, in which there exists any possibility that the insured may be held liable for damages where facts are alleged within the coverage of the policy.

National Grange Mutual Ins. Co. v. Continental Casualty Ins. Co., 650 F. Supp. 1404,

liability imposed on the insured[97] under comprehensive general liability policies ("CGL") and other similar excess and umbrella liability insurance policies. Insurers typically have responded to notice of such claims with "reservation of rights letters"[98] and in some cases have denied coverage for the CERCLA claims altogether. A declaratory judgment action concerning defense and coverage between insured and insurer often follows.

Recently there has been an explosion of such coverage litigation. As little as two years ago, there were barely ten reported decisions in the United States directly addressing environmental insurance coverage issues.[99] Today there are over fifty such decisions, and scores of enormous coverage cases presently are being litigated.[100] Many jurisdictions lack appellate court decisions resolving the issues that are typically disputed between insured and insurer in environmental claims. Indiana only has one appellate decision directly addressing any of the major issues in this area and that case had limited significance due to its unusual facts.[101]

1407 (S.D.N.Y. 1986) (citations omitted).

Typically courts will use a "comparison test" to determine whether its duty to defend has been triggered. This test looks at the allegations in a complaint filed against an insured in an attempt to determine whether there are any allegations for which there could be coverage under the policy regardless of the merits of the claim. *See, e.g.*, Jonesville Products, Inc. v. Transamerica Ins. Group, 156 Mich. App. 508, 402 N.W.2d 46, 47 (1986); American States Ins. Co. v. Maryland Casualty Co., 587 F. Supp. 1549, 1551 (E.D. Mich. 1984). If such an allegation is made, the courts will usually find that there is a duty to provide a defense to the insured unless it appears "as a matter of law" that there would be no coverage under the policy for the actions of the insured. *See also* Travelers Indem. Co. v. Dingwell, 414 A.2d 220 (Me. 1980).

[97]The insurer's duty to indemnify is the obligation to reimburse the insured for any monies that the insured is obligated to pay as "damages" which are the result of a covered occurrence.

[98]A "reservation of rights" letter usually tells the insured that the insurer believes there are potential grounds to deny coverage for the claim the insured has made. "[A] reservation of rights . . . to be effective, must be communicated to the insured. It must fairly inform the insured of the insurer's position and must be timely, although delay in giving notice will be excused where it is traceable to the insurer's lack of actual or constructive knowledge of the available defense." 14 G. COUCH, COUCH ON INSURANCE (2d Rev. ed.) § 51:88 (1982).

The reservation of rights letters received by insureds who file environmental claims generally allege one or more of the following grounds: (1) lack of a covered "occurrence," (2) lack of bodily injury or property damage occurring during the policy period, (3) lack of "property damage" where reimbursement for government-imposed remedial costs is sought or (4) absence of coverage due to a "pollution exclusion."

[99]10 CHEMICAL & RADIATION WASTE LIT. REP. (CCH) 30 (1985).

[100]For example, Westinghouse Electric Corporation and one of its subsidiaries recently sued 155 property and liability insurers who represented all property and liability insurers (including successors) for the companies from 1948 to the present. 1 TOXIC LAW REP. (BNA) 97 (June 24, 1987).

[101]Barmet of Indiana, Inc. v. Security Ins. Group, 425 N.E.2d 201 (Ind. Ct. App.

This article will outline some major issues in environmental insurance coverage disputes and assess trends in recent decisions in these areas.

B. Standard CGL Policy Terms

Policies covering only environmental injuries are quite rare. Typically, insureds have claimed coverage for environmental claims under a CGL policy. The language of the main body of virtually all CGL policies is identical because it is based on insurance industry forms. Policies are individualized by the addition of particular endorsements. Coverage under this type of policy is triggered by a happening or event that meets the policy's definition of an "occurrence." A standard definition of an "occurrence" in the CGL policies typically involved in current claims is "an accident, an event, or a continuous or repeated exposure to conditions which results, during the policy period, in bodily injury or property damage neither expected nor intended by the Insured."[102] The occurrence need not take place and no claim needs to be filed during the period that the policy is in effect, but an event that qualifies as an occurrence must cause either "property damage" or "bodily injury" during the period of time the policy is in effect.

"Property damage" typically is defined as:

> (a) physical injury to or destruction of tangible property, including the loss of use thereof at any time resulting therefrom, or
>
> (b) loss of use of tangible property which has not been physically injured or destroyed, provided such loss of use is caused by an occurrence during the policy period.[103]

1981). There are a number of environmental insurance coverage cases presently in Indiana's state and federal lower courts that may decide many of the issues discussed in this Article. For example, in August, 1987, Great Lakes Chemical Corporation sued 15 of its insurers in state court in Tippecanoe County seeking a declaration that these insurers are obligated to pay defense and indemnification costs for certain environmental claims. Great Lakes Chem. Corp. v. Northwestern Nat'l Ins. Co. of Milwaukee, et. al., now pending as Cause No. 23CO18711CP263 in the Fountain Circuit Court. Conversely, insurance companies sometimes initiate similar actions. In Auto-Owners (Mutual) Ins. Co. v. J & B Metal Finishing, Inc., et. al., Cause No. 87-1038C Division, filed September 29, 1987, a liability insurer seeks similar declaratory relief from such obligations under its policies (The authors represent the insureds seeking insurance coverage.).

[102]United Pacific Ins. Co. v. Van's Westlake Union, Inc., 34 Wash. App. 708, 664 P.2d 1262, (1983). *See also* D. Day & S. Ray, Annotated Comprehensive Liability Policy 3 (Defense Research Institute [hereinafter DRI] 1984); A. Reichenberger, The General Liability Insurance Policies - Analysis of 1973 Revisions (DRI, Vol. 1974 No. 1 Jan. 1974) (a copy of this Article is on file in the offices of the Indiana Law Review).

[103]United Pacific Ins. Co. v. Van's Westlake Union, Inc., 34 Wash. App. 708, 664 P.2d 1262 (1983).

A standard definition of "bodily injury" includes "bodily injury, sickness or disease sustained by any person which occurs during the policy period."[104]

Covered occurrences are subject to certain express exclusions from coverage found in another portion of the standard form CGL policy. The most significant exclusion for environmental claims is the so-called "pollution exclusion." This commonly provides:

> This insurance does not apply:
>
> . . . .
>
> (f) to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water; but this exclusion does not apply if such discharge, dispersal, release, or escape is sudden and accidental.[105]

C. Existence of an Occurrence

The first issue that must be addressed to determine whether there is coverage under a CGL policy is whether there has been an "occurrence." The historical background behind the inclusion of the requirement of an "occurrence" in the standard CGL policy is revealing. Insurers often insist that the requirement of an "occurrence . . . neither expected or intended by the Insured" bars coverage for claims arising from intentional release or deposit of wastes, especially repeated releases or deposits over a long period of time, where it was reasonably foreseeable that these wastes might damage the environment.

At least with respect to environmental claims, however, contemporaneous industry commentary on the 1966 CGL policy does not support the insurers' present contention that there was any intent to avoid coverage, even for extended pollution claims. At an insurance industry meeting in 1965 G.L. Bean, Assistant Secretary, Liberty Mutual Insurance Company, gave a precisely contrary assessment, stating that when the new CGL policy went into effect:

> [I]t is in the waste disposal area that a manufacturer's basic premises-operation coverage is liberalized most substantially. Smoke, fumes, or other air or steam pollution have caused an endless chain of severe claims for gradual property damage. The waste disposal cases have been difficult ones, because when the

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[104]Acands, Inc. v. Aetna Casualty & Surety Co., 764 F.2d 968, 971 (3d Cir. 1985).
[105]*Barmet*, 425 N.E.2d at 202.

> injury or damage first starts to emerge, no corrective action is taken in many cases, because the manufacturer is reluctant to admit his waste disposal is causing it. This is probably an honest doubt. When the case is pinpointed, it may or may not be easy to make a quick elimination of the cause. The cost of an alternative method of waste disposal may be terrifically expensive or might even force the manufacturer out of business, and even if it can be made, it may take months to convert.[106]

Lyman Baldwin, Secretary of Underwriting for the Insurance Company of North America, amplified this understanding in 1966:

> Let us consider how this would apply in a fairly commonplace situation where we have a chemical manufacturing plant which, during the course of its operations, emits noxious fumes that damage the paint on buildings in the surrounding neighborhood. Under the new policy there is coverage until such time as the insured becomes aware that the damage was being done. If he continues the operation causing the damage, coverage would not apply subsequent to the time of his becoming aware of the damage. Naturally, if he could reasonably have anticipated that the damage would ensue there would be no coverage at all for it certainly would not have been unexpected.[107]

Plainly insurers contemplated continued coverage for volitional releases or deposits even over an extended period of time, of pollutants, and the "occurrence" requirement was not added to block such claims.

In the face of such comments and further contemporaneous industry commentary and representations concerning the "pollution exclusion," added in 1970 and discussed below, it is clear that insurers will have a difficult time proving an intention in 1966 to exclude coverage of most current environmental claims. As discovery proceeds in coverage cases, more examples of exactly contradictory evidence—that the new CGL policy plainly was intended to cover such claims—are surfacing.

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[106]*New Comprehensive Guaranty and Automobile Program, The Effect on Manufacturing Risks*, paper presented at Mutual Insurance Technical Conference, November 15-18, 1965 at 6 (a copy is on file in the office of the Indiana Law Review). Mr. Bean made a similar point in a 1966 paper on the new policy, citing the following as covered liabilities: "gradual BI or gradual PD resulting over a period of time from exposure to the insured's waste disposal. Examples would be gradual adverse effect of smoke, fumes, air or stream pollution, contamination of water supply or vegetation." *Id.* For this and other aspects of the drafting history of the CGL policy, see generally Anderson & Luppi, *Environmental Risk Insurance: You Can Count On It*, 1987 RISK MANAGEMENT 68.

[107]Anderson & Luppi, *supra* note 106, at 72.

There is nothing extraordinary in finding coverage for claims arising from volitional conduct that results in a tort. Most tort insurance covers this type of conduct. Claims arising from truly unintentional or non-volitional acts are rare. What is typical is a lack of intention of consequences, such as injury from the negligently driven automobile, not the lack of an intention to drive the automobile in the fashion in which it was driven.

Courts in many jurisdictions have found that there has been an occurrence under a CGL policy resulting from pollution claims where the damage occurred as a result of intentional, long-term discharge of pollutants.[108] A handful of courts have denied coverage in long-term discharge cases on the basis that there was no occurrence because the insured's acts relating to the pollution event or events were either intended or expected; however, those decisions generally involve facts in which the insured clearly was or should have been aware of the adverse environmental effects of its actions when the actions occurred.[109] Like many other jurisdictions, Indiana courts have not squarely confronted the issue of whether claims for pollution caused by damage resulting from "innocent" long-term activities are covered.[110]

The judicial interpretation of the phrase "expected or intended" as applied in typical environmental situations makes it evident that the standard definition of "occurence" was pollution claims. On the one hand, waste generator insureds contend that although the insured intended to dispose of its waste at what later becomes a CERCLA cleanup site, the insured neither intended nor expected any eventual harm, and therefore its deposits constituted occurrences. On the other hand, insurers argue that when the generator deposited its wastes usually over a period of several years, it did so intentionally. Futhermore, it was reasonably

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[108]*See, e.g.*, Benedictine Sisters v. St. Paul Fire & Marine Ins. Co., 815 F.2d 1209, 1211 (8th Cir. 1987) (applying South Dakota law); Industrial Steel Container Co. v. Fireman's Fund Ins. Co., 339 N.W.2d 156, 159 (Minn. Ct. App. 1987); Shapiro v. Public Service Mut. Ins. Co., 19 Mass. App. 648, 477 N.E.2d 146, (1985) ("Thus even [where we] view the escape of oil from Shapiro's tank as a foreseeable consequence of an unknown but 'natural progressive condition,' i.e., corrosion, we would not conclude that the escape was 'nonaccidental'"). The *Shapiro* court distinguishes the facts of its case from Barmet of Indiana, Inc. v. Security Ins. Group, 425 N.E.2d 201 (Ind. Ct. App. 1981), "[W]here the insured knew that its pollution control system malfunctioned on a regular and frequent basis and the insured had received numerous complaints concerning its polluting, the discharge of emissions was not sudden and accidental.") *Id.*

[109]*See, e.g.*, American States Ins. Co. v. Maryland Casualty Co., 587 F. Supp. 1549 (E.D. Mich. 1984).

[110]Barmet of Indiana, Inc. v. Security Ins. Group, 425 N.E.2d 201 (Ind. Ct. App. 1981). This case cites no other Indiana decision construing either the pollution exclusion or a CGL policy in an environmental claim.

foreseeable at the time of deposit, and therefore expected, that the hazardous materials might one day escape and contaminate the environment. But courts in most jurisdictions have found that reasonable foreseeability is not alone a sufficient basis for the insurer to argue that the insured expected or intended the resulting damage.[111] In contrast, the court may find a lack of an occurrence if the insurer can show that the insured was aware that property damage was taking place or that human health was being threatened and the insured did nothing to correct the situation, or that an insured is in the business of disposing of hazardous waste.[112]

Moreover, although *Barmet* offers no guidance on the occurrence issue, Indiana's general liability insurance law plainly requires that policy exclusions for intentional conduct are to be construed to exclude only conduct where harmful *consequences* are intended, and not merely the conduct itself. A leading case construed a clause in a homeowner's policy excluding coverage for "bodily injury or property damage caused intentionally by or at the direction of the insured" for its activities.[113] In *Home Insurance Co. v. Neilsen*,[114] the insured sought coverage for an alleged assault; the insurer refused coverage on the basis that an assault was an intentional act. The *Neilsen* court acknowledged the general rule in Indiana that "in an action for assault and battery, a person will be presumed as a matter of law to have intended the natural and probable consequences of his wrongful act."[115] But in the context of insurance coverage, the court required a more specific intent before an insured's conduct would come within an exclusion for "intentional" acts.[116] The court held that the exclusions would apply only where the insurer could show "an actual intent to injure" or that the nature and the character of the act is such that "the intent to cause harm to the other party must be inferred as a matter of law."[117]

This requirement that an insurer show intent to cause specific harm as opposed to merely foreseeable harm in order to deny coverage is

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[111]*See, e.g.*, Benedictine Sisters v. St. Paul Fire & Marine Ins. Co., 815 F.2d 1209, 1211 (8th Cir. 1987); Industrial Steel Container Co. v. Fireman's Fund Ins. Co., 399 N.W.2d 156 (Minn. Ct. App. 1987); and United States Fidelity and Guaranty Co. v. Armstrong, 479 So. 2d 1164 (Ala. 1985).

[112]Steyer v. Westvaco Corp., 450 F. Supp. 384, 388 (D. Md. 1978); American Mutual Liab. Ins. Co. v. Neville Chem. Co., 650 F. Supp. 929, 933 (W.D. Pa. 1987) (applying Pennsylvania law and citing Techalloy Co. v. Reliance Ins. Co., 338 Pa. Super. 1, 47 A.2d 820 (1984)); Great Lakes Container Corp. v. National Union Fire Ins. Co., 727 F.2d 30 (1st Cir. 1984).

[113]Home Ins. Co. v. Neilsen, 165 Ind. App. 445, 332 N.E.2d 240 (1975).

[114]*Id.*

[115]*Id.* at 448, 332 N.E.2d at 242.

[116]*Id.* at 449, 332 N.E.2d at 243.

[117]*Id.* at 451, 332 N.E.2d at 244.

amplified by the decision in *Indiana Lumberman's Mutual Insurance Co. v. Brandum.*[118] There, the Indiana Court of Appeals found coverage for injuries and damage to a woman and a utility company after the insured intentionally rammed his vehicle into a vehicle occupied by his fiancee and another man causing that vehicle to hit and injure the woman and do damage to the utility pole. The court ruled that because the insured only intended to injure the occupants of the car he hit and not the other parties, there was coverage for the other parties' injuries.[119]

Thus, Indiana insureds should prevail on the question of whether there has been an occurrence even where there has been a gradual deposit or release of hazardous wastes into the environment. The history of the "occurrence" requirement favors coverage for such claims. At a minimum that requirement is ambiguous which leaves insurers vulnerable to well established precedent construing ambiguity in favor of coverage. It is indisputable that the phrase "expected" or "intended" is at least susceptible to a construction requiring a conscious intent to do the harm actually suffered and not just to do the act leading to the harm. Courts throughout the United States and the Indiana Supreme Court recently and emphatically have strictly construed ambiguous language against the insurer who drafted the policy and in favor of coverage. Moreover, the majority of cases in other jurisdictions squarely confronting the question have found an occurrence unless it can be shown that the insured intended to dispose of hazardous substances illegally or the insured was aware of a high degree of probability that its hazardous waste would pose an environmental problem.

These holdings are consistent with general Indiana insurance law. In Indiana, the insurer cannot avoid its duty to indemnify solely upon its basis that the act which produced the circumstances giving rise to liability was volitional and not fortuitous. The insurer also must demonstrate that specific harmful consequences of the insured's act were intended.

D. Trigger of Coverage

A second critical issue in environmental coverage disputes between insurers and insureds is when coverage is "triggered," or when the covered "bodily injury" or "property damage" occurred.[120] This timing is important because it determines what coverages will be available to help pay for indemnification or defense costs. Depending upon the "trigger of coverage" theory adopted by the jurisdiction, a single policy

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[118]419 N.E.2d 246 (Ind. Ct. App. 1981).
[119]*Id.* at 248.
[120]Eli Lilly and Co. v. Home Ins. Co. 462 N.E.2d 467, 470 (Ind. 1986).

or a number of policies might apply. Courts have developed, primarily in asbestos and certain delayed manifestation drug exposure cases, various major theories to determine the appropriate trigger for insurance coverage.

The "exposure" theory determines that an injury occurs and coverage is triggered at the point where exposure to the body occurs, even though the injury could not then be diagnosed and the cumulative effects of the damage have not yet manifested themselves as a recognized disease.[121]

Under the "manifestation" theory, an actionable injury occurs at the time an injury first manifests itself, even if the cause of the injury occurred sometime earlier. An injury is manifest when it would be observable and therefore readily diagnosable.[122] The "injury-in-fact" theory requires the fact finder to decide when an "injury" occurred.[123] This theory is based on the premise that the term "injury" is not ambiguous but has a plain meaning that converts this issue into a factual one.

The "multiple trigger" theory also is known as the *Keene* theory because it was first decisively articulated in *Keene Corp. v. Insurance Co. of North America*.[124] The court in *Keene* held that asbestos injuries was progressive and constituted a single continuous harm, therefore, each insurer whose policy was in effect at any time during the period of exposure, exposure-in-residence,[125] or manifestation of the injury is jointly and severally liable for the entire harm. The *Keene* approach has been discussed and adopted in two recent pollution cases, *Pacific Indemnity Co. v. Bunker Hill Co.*,[126] and *National Standard Insurance Co. v. Continental Insurance Co.*[127] In both cases the courts decided,

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[121]*See, e.g.*, Ducre v. The Executive Offices of Halter Marine, Inc., 752 F.2d 976 (5th Cir. 1984) (applying Louisiana law), *reh'g denied en banc*, 758 F.2d 651 (5th Cir. 1985); Porter v. American Optical Corp., 641 F.2d 1128 (5th Cir. 1981) (applying Louisiana law), *cert. denied*, 454 U.S. 1109 (1981), *reh'g denied* 455 U.S. 1009 (1982); Insurance Co. of North America v. Forty-Eight Insulations, Inc., 633 F.2d 1212 (6th Cir. 1980), *aff'd on rehearing*, 657 F.2d 814 (1981), *cert. denied*, 454 U.S. 1109 (1981).

[122]*See, e.g.*, Eagle-Picher Indus. Inc. v. Liberty Mut. Ins. Co., 682 F.2d 12 (1st Cir. 1982), *cert. denied*, 460 U.S. 1028 (1983).

[123]*See* American Home Products Corp. v. Liberty Mutual Ins. Co., 748 F.2d 760 (2d Cir. 1984).

[124]667 F.2d 1034 (D.C. Cir. 1981).

[125]"Exposure-in-resident" is the concept that with a long developing condition such as asbestosis "the body [repeatedly] incurs microscopic injury as asbestos fibers become lodged in the lungs and as the surrounding tissue reacts to the fibers thereafter." *Keene*, 687 F.2d at 1042.

[126]Civ. No. 79-2010, slip op. (D. Idaho July 3, 1984).

[127]CA-3-81-1015-D, slip op. (N.D. Tex. Oct. 4, 1983). *See* Anderson & Luppi, *supra* note 106, at 72 for contemporaneous insurance industry commentary making it plain that insurers believed a multiple trigger approach should apply to pollution claims.

as the *National Standard* court stated, "that all insurers on the risk between the initial exposure and the time of the manifestation are obligated to defend" the insured against bodily injury claims.[128]

In *Eli Lilly and Co. v. Home Insurance Co.*,[129] the Indiana Supreme Court adopted the multiple trigger approach. *Home Insurance* involved a large number of DES products liability claims made against Eli Lilly and Company for which Lilly was seeking insurance coverage from its liability insurers. The plaintiffs in such cases generally allege injuries from exposure to DES many years prior to manifestation of any injury. The Indiana Supreme Court stated a strong insurance law and public policy preference for the coverage trigger theory that would most likely meet insureds' reasonable expectations of coverage:

> In order to achieve the objectives of Indiana law, of giving effect to the policies' dominant purpose of indemnity, we hold that coverage is triggered at any point between ingestion of DES and the manifestation of DES-related disease. This holding comports with the rule of interpretation that courts should strive to give effect to the reasonable expectations of the insured.[130]

The multiple trigger theory should apply to Indiana insureds' pollution claims.[131] The similarities between a DES drug case and the typical fact pattern in pollution cases are striking. Each involve claims from prolonged exposure to foreign substances resulting in a delayed manifestation of injury. Each involves the insured's reasonable expectations of coverage throughout the period of its activities. Application of the multiple trigger theory in pollution claims cases will serve the same policies and objectives of the law that guided the Indiana Supreme Court in *Home Insurance.* To apply any other trigger theory would be inconsistent with *Home Insurance*, would defeat the reasonable expectations of insureds in Indiana, and would not serve the public interest of Indiana in making the maximum amount of funds available to pay legitimate claims for any harm to Indiana residents and natural resources.

E. Coverage for Cleanup Costs as Property Damage

A third crucial issue in environmental insurance disputes is whether costs of cleanups required by governmental agencies are covered "property damage" under a CGL policy.

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[128]National Standard Ins. Co. v. Continental Ins. Co., CA-3-81-1015-D, slip op. at 6 (N.D. Tex. Oct. 4, 1983).

[129]482 N.E.2d 467 (Ind. 1985).

[130]*Id.* at 471.

[131]*Development in the Law, Toxic Waste Litigation*, 99 Harv. L. Rev.1458, 1581-83 (1986); Note, *The Applicability of General Liability Insurance to Hazardous Waste Disposal*, 57 S. Cal. L. Rev. 745, 758-59 (1984); Anderson & Luppi, *supra* note 106, at 72.

1. What Qualifies as "Property Damage"?—Courts have divided over whether governmentally imposed cleanup costs are covered, but a clear majority favor inclusion of such costs as "property damage."[132] In *Lansco, Inc. v. Department of Environmental Protection*[133] one of the first and leading decisions in this area, the New Jersey court declared that the insurer's argument that "property damage" be construed only as "measurable damage to identifiable physical property" was "without merit."[134] The court determined the insurer was obligated to pay the cleanup costs associated with a spill of oil from Lansco's facility because Lansco "could have reasonably expected to be indemnified for any liability arising out of the operation of its business which was not specifically excluded."[135] The court also noted that the New Jersey spill law mandating cleanup of spills "fixed as a measure of damages the cost of eliminating the harmful substance from the waters of the State. Hence, the cost of cleanup determines the amount Lansco became legally

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[132]*See, e.g.*, Continental Ins. Cos. v. Northeastern Pharmaceutical Chem. Co., 811 F.2d 1180, 1184-87 (8th Cir. 1987), *petition for reh'g en banc granted*, 815 F.2d 51 (8th Cir. 1987); New Castle v. Hartford Accident and Indemnity Co., No. 85-436 JLL, slip op. at 15-19 (D. Del. Nov. 2, 1987); Fireman's Fund Ins. Cos. v. Ex-Cell-O Corp., 662 F. Supp. 71, 76 (E.D. Mich. 1987) ("damages" in CGL policies encompass "money spent to clean up environmental contamination" in CERCLA case); Gloucester v. Maryland Casualty Co., 661 F. Supp. 394 (D.N.J. 1987); Powers Chemco, Inc. v. Federal Ins. Co., No. 8462/85, slip op. at 4 (N.Y. Sup. Ct. Nassau County, Apr. 3, 1987) ("It is the Court's opinion that the cost of complying with the [Department of Environmental Conservation] order insofar as they can be attributed to restoring the groundwater and environment to its pre-contamination state and preventing future contamination constitutes damages within the meaning of the policy."); Consolidated Rail Corp. v. Certain Underwriters at Lloyds, No. 84-2669, slip op. at 11 (E.D. Pa. June 3, 1986); Independent Petrochemical Corp. v. Aetna Casualty & Sur. Co., No. 83-3347, slip op. (D.D.C. May 2, 1986) (cleanup costs in CERCLA action from alleged dioxin contamination constitute damages for purposes of liability insurance coverage); Port of Portland v. Water Quality Ins. Syndicate, 549 F. Supp. 233 (D. Or. 1982), *aff'd in part, rev'd in part*, 796 F.2d 1188 (9th Cir. 1986); Bankers Trust Co. v. Hartford Accident and Indemnity Co., 518 F. Supp. 371 (S.D.N.Y. 1981); Chemical Applications Co. v. Home Indemnity Co., 425 F. Supp. 777 (D. Mass. 1977); United States Aviex Co. v. Travelers Ins. Co., 125 Mich. App. 579, 336 N.W.2d 838 (1983); Lansco, Inc. v. Department of Envtl Protection, 138 N.J. Super. 275, 350 A.2d 520 (N.J. Super. Ct. Ch. Div. 1975), *aff'd*, 45 N.J. Super. 433, 368 A.2d 363 (App. Div. 1976) *cert. denied*, 73 N.J. 57, 372 A.2d 322 (1977); Kutsher's Country Club Corp. v. Lincoln Ins. Co., 119 Misc. 2d 889, 465 N.Y.S.2d 136 (Sup. Ct. 1983); Waste Management of the Carolinas, Inc. v. Peerless Ins. Co., 72 N.C. App. 80, 323 S.E.2d 726 (1984), *rev'd on other grounds*, 315 N.C. 688, 340 S.E.2d 374 (1986).

[133]138 N.J. Super. 275, 350 A.2d 520 (1975), *aff'd*, 45 N.J. Super. 433, 368 A.2d 363 (App. Div. 1976), *cert. denied*, 73 N.J. 57, 372 A.2d 322 (1977).

[134]138 N.J. Super. at 282, 350 A.2d at 524.

[135]*Id.*

obligated to pay and the amount for which it is entitled to indemnification."[136]

Recently, the Eighth Circuit in *Continental Insurance v. Northeastern Pharmaceutical Chemical Co.* decided that under Missouri law, both the state and the federal governments suffered "property damage" by reason of the pollution involved and that the cost of cleaning up the environmental damage imposed upon the insured was properly indemnifiable by the insurer as "property damage" under a standard CGL policy.[137] The court first determined that not only private individuals who own land, but also the government of the United States and the government of the State of Missouri have an interest in the contaminated property sufficient to have stated a claim for "property damage."[138] The court justified its conclusion that environmental pollution fell within the standard CGL policy's definition of "property damage" in part by looking to the policy's "pollution exclusion" which the court noted "itself states that 'property damage' may result from the discharge of pollutants."[139] The court also agreed with *Lansco* that cleanup costs were the equivalent of damages that might be imposed after a trial.[140]

Similarly, the court in *United States Aviex Co. v. Travelers Insurance Co.*,[141] rejected the insurer's contention that mandated cleanup costs are equitable relief and not damages required to be indemnified under a CGL policy. The *Aviex* court responded that this was a distinction without a difference:

> If the state were to sue in court to recover traditional "damages," including the state's cost incurred in cleaning up the contamination, for the injury to the groundwater, [the insurer's] obligation to defend against the lawsuit and to pay damages would be clear.
>
> It is merely fortuitous from the standpoint of either plaintiff or defendant that the state has chosen to have plaintiff remedy the contamination problem, rather than choosing to incur the cost of clean-up itself and the suing plaintiff to recover those costs. The damage to the natural resources is simply measured in the cost to restore the water to its original state.[142]

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[136] *Id.* at 284, 350 A.2d 525.

[137] 811 F.2d 1180 (8th Cir. 1987).

[138] *Id.* at 1185-86.

[139] *Id.* at 1186-87 (citing Port of Portland v. Water Quality Ins. Syndicate, 549 F. Supp. 233, 235 (D. Or. 1982)).

[140] *Id.* at 1188.

[141] 125 Mich. App. 579, 336 N.W.2d 838 (1983).

[142] *Id.* at 589-90, 336 N.W.2d at 843 (citing *Lansco*, 138 N.J. Super. 275, 350 A.2d 520 (1975)).

A few courts have expressed a contrary view, holding that cleanup costs and any costs associated with injunctive relief are not legal "damages," but are equitable relief not covered by the CGL policy. A federal district court in Maryland in *Maryland Casualty Co. v. Armco, Inc.*[143] granted an insurance company summary judgment in its declaratory judgment action on the duty to defend a CERCLA action against the insured. The court ruled that the CERCLA action was an equitable action and "[t]raditionally, courts have found no insurance coverage for costs of complying with an injunction even in cases where the suits could have been brought for damages."[144] The court upheld the insurance company's position that the CGL policy intended to draw the line "at the historic division between law and equity."[145]

The district court in *Maryland Casualty* was upheld on appeal by the Fourth Circuit.[146] Judge Chapman, writing the opinion for the court, stated that "[t]he best approach in construing the term "damages" as contained in this insurance contract is to afford it the legal, technical meaning . . . ."[147] The court expressed concern that if "damages" were given a broad reading by the court, it would permit "any obligation to pay" to be covered by the insurance contract.[148]

Judge Chapman also recently wrote the majority opinion in *Mraz v. Canadian Universal Insurance Co.*[149] which reversed a frequently cited lower court decision[150] which had found that the insurer had the duty to defend the insured in a government cleanup action. The Fourth Circuit found that the response costs sought by the government under CERCLA were an "economic loss" and therefore not a loss within the policy's definition of property damage.[151] It is noteworthy that the *Mraz* case involved costs expanded to prevent future harm to the environment and not costs of cleanup of past harm.

There is little to recommend the minority view that cleanup costs are not property damage. It is not supported by the history of the CGL policy. When it was rewriting the CGL policy in 1966, the insurance industry added a provision that required the insured to undertake and pay for cleanup. William J. Obrist of the General Accident Group, described the proposed provision as follows: "At his own expense, the

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[143]643 F. Supp. 430 (D. Md. 1986), *aff'd*, 822 F.2d 1348 (4th Cir. 1987).

[144]643 F. Supp. at 434 (citations omitted).

[145]*Id.* at 435.

[146]822 F.2d 1348 (4th Cir. 1987).

[147]*Id.* at 1352.

[148]*Id.*

[149]804 F.2d 1324 (4th Cir. 1986).

[150]Mraz v. Canadian Universal Ins. Co., 616 F. Supp. 1173 (D. Md. 1985).

[151]*Mraz*, 804 F.2d at 1329.

named insured must promptly take all reasonable steps to prevent other bodily injury or property damage from arising out of the same or similar conditions."[152] But this requirement was removed from the CGL policy in 1973.[153] Some companies added an endorsement requirement policy-holder cleanup, but most CGL policies applicable to current environmental claims do not contain any such requirement. Because this express exclusion was once included and then removed, the appropriate inference is that insurers anticipated, at least after 1973, that there was coverage for such costs.[154]

Second, irrespective of the drafting history, coverage of such costs makes sound legal and policy sense. *Mraz* and *Maryland Casualty* place too much emphasis upon traditional formal pleading rules without substantive significance. As several courts have held, the plain meaning of "property damage," what an ordinary, reasonable, policy holder would expect to have covered in a liability insurance policy, would include such cleanup costs.[155] This is especially true because these policies are represented as *comprehensive* general liability policies.[156] Moreover, to the extent there is any ambiguity in the phrase "property damage," it must be construed against the drafter-insurer and in favor of indemnity for the insured.[157]

There is no principled distinction between costs incurred by private parties in a CERCLA-imposed cleanup and damages awarded against the same parties after the government or some other private party does the same cleanup. Liability under CERCLA and similar statutes is liability for the costs of cleanup, not merely the actions involved, and is a traditional damage liability. In addition, CERCLA is intended to discourage litigation and to encourage private party cleanups, which generally are much more economical than government-conducted cleanups. Those purposes are frustrated if insurance policies are construed to provide coverage only for a traditional damage award obtained after someone else has done the cleanup.

F. Application of the "Pollution Exclusion"

The "pollution exclusion" is the last hurdle to coverage for environmental claims. The exclusion in the CGL policy purports to exclude

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[152] W. J. Obrist, *quoted in* Anderson & Luppi, *supra* note 106, at 69.

[153] Reichenberger, *supra* note 102, at 12.

[154] Anderson & Luppi, *supra* note 106, at 69.

[155] *See, e.g.*, Queen City Farms, Inc. v. Aetna Consol. Sur. Co., No. 86-2-06236-0, slip op. at 6-7 (Wash. S. Ct. Kings Cty. Sept. 4, 1987) Port of Portland v. Water Quality Ins. Syndicate, 796 F.2d 1188, 1194-95 (9th Cir. 1986).

[156] National Screen Service Corp. v. United States Fidelity & Guar. Co., 364 F.2d 275, 279-80 (2d. Cir. 1965), *cert. denied*, 385 U.S. 958 (1966).

[157] Eli Lilly & Co. v. Home Ins. Co., 482 N.E.2d 467, 471 (Ind. 1985).

pollution claims, but it "does not apply if such discharge, disposal, release or escape is sudden and accidental." Even if the insured can demonstrate that the claim it made with the insurer involved an occurrence that caused either property damage or bodily injury during the policy period, the insurer may still contend that the pollution exclusion releases the insurer from its duty to indemnify the insured.

The critical language in the exclusion is the exception for "sudden and accidental" pollution. Many more recently issued CGL policies have incorporated "absolute" pollution exclusions, which purportedly absolutely exclude coverage for claims caused by pollution because these modified exclusions do not contain the "sudden and accidental" clause.[158]

To date, most courts have found that the pollution exclusion does not effectively exclude most environmental claims. A number of courts have held the language of the pollution exclusion is fundamentally ambiguous or insignificant, and have therefore found coverage. These courts have followed two basic lines of reasoning in finding coverage. The first is that the phrase "sudden and accidental" is by itself ambiguous, and should be construed to find coverage.[159] The second is that the pollution exclusion is nothing more than a restatement of the definition of occurrence, and allows coverage except in cases in which the pollution and damage from the pollution is expected or intended.[160]

The ambiguity in the phrase "sudden and accidental" is patent. Insurers contend that "sudden and accidental" should be construed in a temporal sense, meaning immediate or swift. But insureds point to the ordinary dictionary definitions of unexpected or unanticipated. The "unexpected or unanticipated" interpretation of the phrase makes sense on two levels—both the pollution event and its harmful consequences can be unexpected or unintended. In contrast, the "immediate or swift" interpretation makes no sense at all if applied at the damage level. Why should delayed manifestation from a pollution event not be covered, but damage appearing immediately or swiftly be covered? The temporal construction would bar coverage on many claims, conversely the unexpected or unanticipated construction is much more likely to lead to

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[158]Chesler, Rodburg, Smith, *Patterns of Judicial Interpretation of Insurance Coverage for Hazardous Waste Site Liability*, 18 RUTGERS L.J. 9, 21 n.362 (1986). This article presents a comprehensive and cogent discussion of the decisions in this area of the law.

[159]*See* Buckeye Union Ins. Co. v. Liberty Solvents & Chem. Co., 17 Ohio App. 3d 127, 477 N.E.2d 1227, 1234 (1984); Molton, Allen and Williams, Inc. v. St. Paul Fire and Marine Ins. Co., 347 So. 2d 95 (Ala. 1977). This case limited the pollution exclusion to industrial pollution. This consideration has not been followed by courts in other jurisdictions.

[160]Jackson Township Mun. Util. Auth. v. Hartford Accident and Indem. Co., 186 N.J. Super. 156, 451 A.2d 990 (1982). *See also* City of Northglenn v. Chevron USA, Inc., 634 F. Supp. 217, 222 (D. Colo. 1986).

the conclusion that there is liability coverage. Faced with this ambiguity most courts have resolved the issue in favor of indemnity and insureds.

Two landmark New Jersey cases have laid the framework for the majority view favoring the converse for most pollution events. First, in *Lansco, Inc. v. Department of Environmental Protection*[161] the court identified the ambiguities in the language of the exclusion and found coverage where the event of pollution was neither expected nor intended by the insured.

In *Jackson Township Municipal Utility Authority v. Hartford Accident and Indemnity Co.*, New Jersey reaffirmed the presence and consequences of the exclusion's ambiguity:

> If there exists a problem of construction of the policy, that is, if the controlling language will support two meanings, one favorable to the insured and the other favorable to the insurer, the interpretation sustaining coverage must be applied.[162]

The court summarized and embraced the expansion of the ambiguity, identified in *Lansco*:

> Thus, almost unanimously, the courts in other jurisdictions go one step beyond *Lansco* . . . in finding that the pollution clause is ambiguous. In *Lansco* the occurrence was sudden and accidental because the event was unexpected, whereas in each of the other cases the court held the occurrence to be sudden and accidental because the result or injury was unexpected or unintended.[163]

As the *Jackson* court pointed out, the interpretation of the phrase "sudden and accidental" to mean unanticipated or unintended is consistent with the definition of a covered "occurrence" in the policy. Indeed, "when viewed in light of the case law cited, the clause can be interpreted as simply a restatement of the definition of 'occurrence'—that is, that the policy covers claims where the injury was 'neither expected nor intended'."[164] Viewing the facts from the standpoint of the insured, the court stated that "the function of depositing the waste may have been intentional but it was never expected or intended that the waste would seep into the aquifers resulting in damage and injury

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[161]138 N.J. Super. 275, 350 A.2d 520 (1975), *aff'd*, 145 N.J. Super. 433 (App. Div. 1976), *cert. denied*, 73 N.J. 57, 372 A.2d 322 (1977).

[162]186 N.J. Super. 156, 161, 451 A.2d 990, 992 (1982) (citing Mazzilli v. Accident & Casualty Ins. Co. of Winterthur, 35 N.J. 1, 170 A.2d 800 (1961)).

[163]*Jackson*, 186 N.J. Super. at 164, 451 A.2d at 994.

[164]*Id.*

to others."[165] The court found it irrelevant that the seepage into the groundwater was gradual rather than sudden because the seepage was unexpected.[166] The *Jackson* court identified by example the types of cases in which the pollution exclusion would apply:

> The chemical manufacturer or industrial enterprise who discharges, disburses or deposits hazardous waste material knowing, or who may have been expected to know, that it would pollute, will be excluded from coverage by the clause. The industry, for example, which is put on notice that its emissions are a potential hazard to the environment and who continues those emissions is an active polluter excluded from coverage.[167]

The *Jackson* court's equation of the pollution exclusion with the requirement in the definition of occurrence that the damage be neither expected nor intended is supported by mounting evidence concerning the drafting and regulatory history of the exclusion. The exclusion was drafted and submitted to the various state insurance commissioners in 1970. The Mutual Insurance Rating Bureau, an insurance industry association which helped draft and submit the exclusion, wrote memoranda to the insurance commissioners which set forth the purpose of the exclusion: "This endorsement is actually a clarification of the original intent, in that the definition of occurrence excludes damages that can be said to be expected or intended."[168] The memoranda stated that the exclusion was being added only to clarify that expected or intended pollution was not covered.

The regulators took the insurers at their word. West Virginia's insurance commissioner, for example, expressly relied upon these representations in approving the exclusion. In an order dated August 19, 1970, the Commissioner ruled:

> (1) The said companies [INA, Travelers, American Home, St. Paul and American States] and rating organizations have represented to the Insurance Commissioner, orally and in writing, that the proposed exclusions . . . are merely clarifications of existing coverage as defined and limited in the definitions of the term 'occurrence', contained in the respective policies to which said exclusions would be attached;
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> (2) to the extent that said exclusions are mere clarifications of existing coverages, the Insurance Commissioner finds that

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[165] *Id.*

[166] *Id.*

[167] *Id.*

[168] Mutual Insurance Rating Bureau, Submission to West Virginia Commissioner of Insurance, July 30, 1970, *quoted in* Anderson & Luppi, *supra* note 106, at 70.

there is no objection to the approval of such exclusions.[169]

Thus, it is clear that the insurance industry represented the exclusion as nothing more than a restatement of the requirement in the definition of occurrence that a covered loss be unexpected and unintended. Recently, courts have expressly relied upon this drafting history to buttress the majority authority restricting the pollution exclusion to active polluters.[170] In *Kipin Industries, Inc. v. American Universal Insurance Co.*, for example, insurers sought to use the exclusion to escape coverage for claims—including CERCLA claims—made against non-active polluters, companies which had contracted for waste disposal with a firm which allegedly had mishandled the wastes. The Ohio Court of Appeals neatly summarized the limited application of the exclusion:

> The claim must be construed strictly against the insurer because it is ambiguous in meaning and its subject matter is an exclusion from what is stated to be comprehensive coverage against liability. We find in the record before us a 1970 circular to the members of the Insurance Rating Board that in discussing [the pollution exclusion], states that the clause is intended to clarify the definition of "occurrence" so as to exclude coverage for expected or intended results. [The pollution exclusion] does not bar coverage in this case.[171]

Kipin and similar decisions make it plain that courts are increasingly inclined to make insurers adhere to their contemporaneous portrayal of this exclusion as nothing more than a clarification that the intentional "active" polluter is not covered, but that non-active polluters—the great majority of CERCLA claimants—are covered.

Numerous decisions have applied a similar distinction to find coverage for innocent as opposed to knowing or intentional pollutants. This approach was first adopted in *Niagara County v. Utica Mutual Insurance Co.*.[172] *Niagara* involved the Love Canal claims. In that case, the court found that the pollution exclusion was ambiguous and that it did not

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[169] August 19, 1970 Order of the Insurance Commissioner of the State of West Virginia in a proceeding entitled "Pollution and Contamination: Exclusion Filings," Administrative No. 70-4, p. 3 & 1 *quoted in* Anderson & Luppi, *supra* note 106, at 70.

[170] Kipin Industries, Inc. v. American Universal Ins. Co., No. A-8505288, slip op. (Ohio Ct. App., Aug. 12, 1987); *See also* Broadwell Realty Servs., Inc. v. Fidelity & Casualty Co. of New York, 218 N.J. Super. 516, 528 A.2d 76 (N.J. Super. Ct. App., Div. 1987).

[171] *Kipin*, slip op. at 8-9.

[172] 103 Misc.2d 814, 427 N.Y.S.2d 171 (1980), *aff'd*, 80 A.D.2d 415, 439 N.Y.S.2d 538 (1981), *appeal dismissed*, 54 N.Y.S.2d 608, 427 N.E.2d 1191, 443 N.Y.S.2d 1030 (1981).

apply to the insured, the county government. The court held that the exclusion should apply only to an "active polluter," a culpable party, as opposed to a party who is liable because of the strict liability that attaches to the improper disposition of hazardous materials under federal and state law. The court in *United Pacific Insurance Co. v. Van's Westlake Union, Inc.*,[173] similarly found coverage by applying the "active polluter" doctrine from *Niagara County*.

In light of the extensive and continually expanding authority[174] and evidence limiting applicability of the pollution exclusion, most insureds should have little difficulty overcoming insurers' present efforts to reconstruct the exclusion. While there are some decisions in which the pollution exclusion has operated to disallow coverage,[175] those cases clearly are a minority view. Moreover, in a number of these decisions there was not an occurrence because the insured either intended or expected the damage, which means the court should have ended its inquiry before reaching the pollution exclusion.

The only Indiana appellate decision construing the pollution exclusion is such a special intentional pollution case. In *Barmet of Indiana, Inc. v. Security Insurance Group*,[176] the Indiana Court of Appeals found that the emissions from the insured's plant were neither sudden nor accidental because the insured's pollution control system malfunctioned on a regular and frequent basis. The insured was on notice of the regular escape of gases due to neighbors' complaints. The court was not impressed by the insured's claim that the emissions were either unforeseeable or unpre-

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[173]34 Wash. App. 708, 664 P.2d 1262 (1983).

[174]*See, e.g.*, Fireman's Fund Ins. Co. v. Ex-Cell-O Corp., 662 F. Supp. 71 (E.D. Mich. 1987); Payne v. United States Fidelity and Guaranty Co., 625 F. Supp. 1189, 1193 (S.D. Fla. 1985); United States Fidelity and Guaranty Co. v. Armstrong, 479 So. 2d 1164, 1168 (Ala. 1985); Molton, Allen and Williams, Inc. v. St. Paul Fire and Marine Ins. Co., 347 So. 2d 95 (Ala. 1977); Reliance Ins. Co. of Illinois v. Martin, 126 Ill. App. 3d 94, 467 N.E.2d 287 (1984); Willett Truck Leasing Co. v. Liberty Mut. Ins. Co., 88 Ill. App. 3d 133. 410 N.E.2d 376 (1980); Jonesville Products, Inc. v. Transamerica Ins. Group, 156 Mich. App. 508, 402 N.W.2d 46, 48 (1986); Autotronic Systems, Inc. v. Aetna Life and Casualty, 89 A.D.2d 401, 456 N.Y.S.2d 504 (1982); Niagara County v. Utica Mut. Ins. Co., 80 A.D.2d 415, 439 N.Y.S.2d 538, *appeal denied*, 54 N.Y.S.2d 831 (1981); Allstate Ins. Co. v. Klock Oil Co., 73 A.D.2d 486, 426 N.Y.S.2d 603 (1980); United Pacific Ins. Co. v. Van's Westlake Union, Inc., 34 Wash. App. 708, 664 P.2d 1262 (1983).

[175]*See, e.g.*, Fischer & Porter Co. v. Liberty Mutual Ins. Co., 656 F. Supp. 132, 139-40 (E.D. Pa. 1986) (citing Great Lakes Container Corp. v. National Union Fire Ins. Co., 727 F.2d 30, 33-34 (1st Cir. 1984)); American States Ins. Co. v. Maryland Casualty Co., 587 F. Supp. 1549, 1552-53 (E.D. Mich. 1984); Techalloy Co. v. Reliance Ins. Co., 487 A.2d 820 (Pa. Super. Ct. 1984).

[176]425 N.E.2d 201 (Ind. Ct. App. 1981).

dictable.[177] Under these special facts, the Indiana court was persuaded that the pollution exclusion provision applied to deny coverage.

The *Barmet* decision highlights the critical requirement in Indiana's general insurance law discussed above that before an insurer can deny coverage for an intentional act, it must show that the insured knew or had reason to know that its act would cause harm.[178] The *Barmet* insured could foresee and expect that harm might come from its air pollution, even if it probably did not intend for the vapors to blow onto a highway and cause an automobile accident. Thus, under Indiana law, there was a basis for the insurer to deny liability because some harm was foreseeable.

Barmet has little significance in the typical circumstances usually confronting insureds and insurers in CERCLA cases. The insureds in *Barmet* were clearly "active" polluters. Typical CERCLA insureds' first notice of a pollution problem is a PRP notification letter from the EPA. *Barmet* plainly is no support for any contention that the pollution exclusion should operate in Indiana to deny coverage in the vast majority of cases in which the insured is not on notice that its operation is causing pollution.

IV. Conclusion

CERCLA liability can arise in a surprisingly wide variety of situations. Such liability can be imposed not only upon companies engaged in hazardous waste management, but also upon those companies' shareholders, directors, officers, and employees. CERCLA liability can arise from mere ownership of contaminated property, and can also arise from the purchase and sale of contaminated property. Even creditors of responsible parties may be exposed to CERCLA liability.

It is not yet possible to define with precision the limits of responsibility under CERCLA, but it is clear that the scope of liability is expanding. It is hoped that the application of CERCLA's liability provisions will become clearer as the limiting principles discussed in this article become more fully developed.

Federal and state courts in Indiana have not yet decided critical questions concerning liability coverage for environmental cleanup costs. Indiana courts should utilize the rapidly developing law concerning these issues in other jurisdictions and Indiana's own already well established general insurance law principles to decide these questions. Indiana courts should have little difficulty in holding that an occurrence has taken place in a typical environmental claim. They may look to prior Indiana in-

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[177]*Id.* at 203.

[178]*See supra* notes 119-24 and accompanying text.

surance decisions which hold that an "occurrence" takes place where the damage or harm was not actively intended by the insured. The courts of this state would be in step with the majority of environmental insurance coverage decisions by finding an occurrence in these circumstances.

In an analogous pharmaceutical case, Indiana's Supreme Court already had adopted the multiple trigger rule for determining which insurers are liable with respect to a particular bodily injury claim.[179] The multiple trigger rule should extend to most environment claims, which typically share vital characteristics with pharmaceutical claims—alleged injury from exposure to a foreign substance. The public policies and precedents cited by the Indiana Supreme Court supporting adoption of the multiple environmental trigger rule in the bodily injury context should be equally persuasive in adopting the same trigger of coverage rule for environmental property damage claims.

Indiana's courts also should hold that government mandated cleanup costs are properly "property damages" as defined by the standard CGL policy. That holding would be consistent with both the history of the CGL policy and the majority of cases addressing this issue in other jurisdictions. There is no principled reason to limit the protection of a *comprehensive* general liability policy so that cleanup costs are not covered.

Finally, the pollution exclusion, based on its drafting history and the sound reasoning of many other courts in other jurisdictions, should not be applied in cases other than those involving an insured engaged in active and intentional pollution. In the typical circumstances of a non-active polluter, named as a PRP in a CERCLA action, the vast majority of jurisdictions find the pollution exclusion to be ambiguous or redundant to the definition of occurrence, and tend to find in favor of the insured to avoid defeating their reasonable expectations of comprehensive liability insurance. Indiana courts should affirm coverage for environmental damage which the insureds neither intended nor expected.

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[179] Eli Lilly and Co. v. Home Ins. Co., 482 N.E.2d 467 (Ind. 1985).

Family Law Survey

James A. Reed*

I. Introduction

The division of marital property remained in the spotlight during this survey period. The 1987 Indiana General Assembly resurrected and breathed new life into the Indiana Court of Appeals opinion in *Luedke v. Luedke*[1] which was vacated by the Indiana Supreme Court during the prior survey period. Indiana Code section 31-1-1.5-11 was amended to require trial courts to presume that an equal division of the marital property is just and reasonable.[2]

Also during this survey period, the Indiana Supreme Court issued two opinions which greatly affect the family law attorney in her everyday practice. First, the supreme court clarified certain issues surrounding educational expense support orders. Second, the supreme court interpreted Indiana's liens on real estate statutes to provide that where one spouse receives his property division in installments over time, the obligation of the payor becomes a lien on her real estate even if there is no specific award of such a lien. This article will discuss all three recent developments and their potential impact on the family law practitioner.

II. *Luedke v. Luedke*: Who had the Last Word?

When the Indiana Supreme Court vacated the Indiana Court of Appeals decision in *Luedke v. Luedke*,[3] the presumption of a "fifty-fifty" division of the marital estate disappeared. The disappearance of the presumed equal division of property was short lived. In 1987, the Indiana General Assembly amended Indiana Code section 31-1-11.5-11(c) by placing in the statute the presumption of an equal division of the marital property.[4] The 1987 amendment, effective with all cases filed on September 1, 1987, and thereafter, reads as follows:

> (c) The Court shall presume that an equal division of the marital property between the parties is just and reasonable. However,

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[1] 476 N.E.2d 853 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985).

[2] Ind. Code § 31-1-1.5-11(c) (Supp. 1987).

[3] 487 N.E.2d 133 (Ind. 1985).

[4] Ind. Code § 31-1-11.5-11(c) (Supp. 1987).

> this presumption may be rebutted by a party who presents relevant evidence, including evidence concerning the following factors, that an equal division would not be just and reasonable:
> (1) The contribution of each spouse to the acquisition of the property, regardless of whether the contribution was income producing.
> (2) The extent to which the property was acquired by each spouse prior to the marriage or through inheritance or gift.
> (3) The economic circumstances of each spouse at the time the disposition of the property is to become effective, including the desirability of awarding the family residence or the right to dwell in that residence for such periods as the court may deem just to the spouse having custody of any children.
> (4) The conduct of the parties during the marriage as related to the disposition or dissipation of their property.
> (5) The earnings or earning ability of the parties as related to a final division of property and final determination of the property rights of the parties.[5]

The 1987 amendment also changed the wording in Indiana Code section 31-1-11.5-11(c)(1) by removing "including the contribution of a spouse as a homemaker"[6] and replacing the phrase with "regardless of whether the contribution was income producing."[7] A cursory review of the 1987 amendments to section 11 may lead the practitioner to conclude that the court of appeals' opinion in *Luedke* has been completely resurrected. This article will address the possible effect of the 1987 amendments on the prior case law.

The division of the marital estate between the parties rests within the sound discretion of the trial court.[8] Indiana Code section 31-1-11.5-11 provides the trial court with guidelines for the division.[9] Prior to the 1987 amendments, Indiana Code section 31-1-11.5-11 simply stated that the court's division must be "just and reasonable" after considering the five factors listed in the statute.[10] On appeal, the appellate court reviews the lower court's decision only for an abuse of discretion. An abuse of discretion exists only if the division is clearly against the logic and effect of the facts and circumstances before the court.[11]

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[5]*Id.*

[6]Ind. Code § 31-1-11.5-11(c)(1) (Supp. 1986).

[7]Ind. Code § 31-1-11.5-11(c)(1) (Supp. 1987).

[8]Irwin v. Irwin, 406 N.E.2d 317, 319 (Ind. Ct. App. 1980).

[9]*Id.*

[10]Ind. Code § 31-1-11.5-11(b) (Supp. 1986).

[11]Temple v. Temple, 435 N.E.2d 259, 260 (Ind. Ct. App. 1982).

In the case *In re Marriage of Osborne*,[12] the court of appeals defined "just" as it is used in the dissolution statutes as follows:

> The terms "just" as employed in the statute [Indiana Code section 31-1-11.5-11] evokes concepts of fairness and equity and of not doing wrong to either party. . . . It would therefore appear that the legislative intent to be considered in ascertaining what is just and reasonable depends upon the facts before the court and that those facts are to be analyzed essentially without reference to sex.[13]

The court of appeals in *Osborne* explained the relationship between the five factors considered by the trial court in determining a "just and reasonable" division as one in which the contribution of one spouse under one subparagraph may be largely offset by that of the other spouse under a different subparagraph.[14] Thus, the appellate court concluded, the division of the marital estate between the parties does not necessarily have to be equal or relatively equal.[15]

The appellate court in *Osborne* attempted to ascertain its role in reviewing the trial court's division, given the seemingly unlimited discretion. The court reasoned as follows:

> What is less clear is the extent to which the court may consider evidence concerning one of the factors and then within its discretion properly minimize the impact of that factor in achieving its final result. We believe the answer lies in the primary, if somewhat nebulous, mandate that the court must be "just and reasonable." In other words, there must be a rational basis for its action, and when there is none, error is committed. Having so said, we reiterate that in many cases other factors will offset a particular contribution by one spouse and will themselves provide the rational basis. This may occur even though there is no specific offsetting occurrence to point to. Thus, for example, the effect of one spouse bringing a vast amount of property into a marriage must be considered by the court. However, the effect of that contribution may in a given case be largely discounted where the property is consumed by the parties during married life or where it, or its equivalent, is maintained or increased through the efforts of both during many years of marriage. Depending upon the total circumstances it may be just

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[12] 174 Ind. App. 599, 369 N.E.2d 653 (1977).

[13] *Id.* at 604-05, 369 N.E.2d at 656.

[14] *Id.* at 605, 369 N.E.2d at 656.

[15] *Id.*

> and reasonable in either instance to accord little weight to a particular spouse's initial contribution in determining the final disposition of property.[16]

In the *Osborne* case, the court of appeals determined that the trial court had abused its discretion when it awarded the husband his inheritance from his mother, who had died just prior to the date of final separation,[17] while awarding the wife virtually all of the assets which the parties had acquired together during the marriage.[18] In reaching its decision the court of appeals reviewed the evidence relevant to each of the five factors of section 11.[19] The *Osborne* opinion provides an attempt to present a clear picture of the interplay of the five factors which the trial court considers when dividing the marital estate. On appeal, however, the standard of review prevents the appellate court from reversing a lower court's decision unless there exists almost overwhelming evidence contrary to the decree.[20]

The apparent frustration of the appellate courts in determining their role in reviewing the trial court's property division orders was relieved in the court of appeals opinion in *Luedke v. Luedke*.[21] In *Luedke*, the court of appeals found the basis of more meaningful review in paragraph (b)(1) of Indiana Code section 31-1-11.5-11.[22] Paragraph (b)(1) focused the court's attention on the contribution of each spouse to the acquisition

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[16]*Id.* at 605, 369 N.E.2d at 656-57.

[17]The "date of final separation" is the date the petition for dissolution is filed. Ind. Code § 31-1-11.5-11(a) (Supp. 1987).

[18]*Osborne*, 174 Ind. App. at 605-06, 367 N.E.2d at 657. "There was no evidence that the wife had done anything to enable the husband to secure, protect or contribute to either the preservation of his mother's estate or his status as a beneficiary. Of course, the bulk of his intestate share had not been received at the time of dissolution. The amount of this inheritance, some $39,000 roughly equalled the total assets produced from the marriage. It appears to us that under such circumstances, awarding substantially all the marital assets to the wife while reserving the inheritance to the husband was against the clear logic and effect of the circumstances within the mandate that the division should be fair and equitable to each. We, therefore, must reverse that part of the judgment decreeing the disposition of property." *Id.* at 606, 369 N.E.2d at 657.

[19]*Id.* at 605-06, 369 N.E.2d at 657.

[20]*See* Lord v. Lord, 443 N.E.2d 847 (Ind. Ct. App. 1982). "Hence, our review of the exercise of discretion in most of these cases is meaningless. Absent an error of law, we merely pronounce in conclusionary terms whether there was an abuse of discretion in the particular circumstances." 443 N.E.2d at 851, n.4.

[21]476 N.E.2d 853 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985). *See* Claus and Perry, *Family Law: Equitable Distribution and Proper Valuation of Marital Property*, 20 Ind. L. Rev. 211, 213-22 (1987).

[22]The five factors now found in section 31-1-11.5-11(c) were in section 31-1-11.5-11(b) in their pre-amended form. *Compare* Ind. Code § 31-1-11.5-11(c) (Supp. 1987) *with* Ind. Code § 31-1-11.5-11(b) (1982).

of the marital estate, including any contribution of a non-wage earner.[23] The court of appeals, in *Luedke*, held that where all other factors in subsection 11(b) are equal, factor (c)(1) requires an even division of the property between the wage earner and the non-wage earner unless one spouse seriously neglected his or her role.[24] The court of appeals went further and erected a rebuttable presumption in paragraph (b)(1) of Indiana Code section 31-1-11.5-11 that the contribution of the homemaker is equal to the contribution of the wage earner.[25] Thus, where the parties had assumed the traditional roles of breadwinner and homemaker, the trial court would start with an equal division of the marital estate. The equal division could be adjusted one way or the other depending upon the evidence regarding the remaining four factors in Indiana Code section 31-1-11.5-11(b).[26]

It was the court of appeals' construction of the rebuttable presumption and the fifty-fifty starting point for the division of the marital estate in *Luedke* that caused the Indiana Supreme Court to vacate the court of appeals' decision and to affirm the trial court's original order.[27] The supreme court found that the court of appeals' presumption placed an unwanted structure on the fact-finding process which could ultimately impair the trial court's ability to weigh all the facts and circumstances of the parties.[28] The supreme court reasoned that if the legislature wanted that kind of structure to be applied to the division of property, it would have to change the language of Indiana Code section 31-1-11.5-11(b).[29] Indeed, the 1987 Indiana General Assembly changed the language of the statute.

The 1987 amendment to Indiana Code section 31-1-11.5-11 in subsection (c) requires the trial court to "presume that an equal division of the marital property between the parties is just and reasonable."[30] The "artificial structure" on the fact-finding process which concerned the supreme court is now part of Indiana's property division statute. Although the 1987 amendment to Indiana Code section 31-1-11.5-11(c) uses the same "rebuttable presumption" language found in the *Luedke* court of appeals opinion,[31] the rebuttable presumption is placed in the

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[23]Ind. Code § 31-1-11.5-11(b)(1) (1982).

[24]476 N.E.2d at 859-60.

[25]*Id.* at 864-65.

[26]*Id.* at 865.

[27]Luedke v. Luedke, 487 N.E.2d 133, 134 (Ind. 1985), *vacating*, 476 N.E.2d 853 (Ind. Ct. App.).

[28]487 N.E.2d at 134.

[29]*Id.*

[30]Ind. Code § 31-1-11.5-11(c) (Supp. 1987).

[31]Luedke v. Luedke, 476 N.E.2d 853 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985).

opening language of subsection (c) and does not appear in paragraph (c)(1).[32] The obvious question for the practitioner is whether the 1987 amendment to Indiana Code section 31-1-11.5-11(c) resurrects the vacated court of appeals opinion in *Luedke*.

The amended Indiana Code section 31-1-11.5-11(c) requires the trial court to presume that an equal division of marital property is just and reasonable.[33] The presumption can be rebutted by evidence concerning the *five* factors found in paragraph (c).[34] The court of appeals in *Luedke* called for a fifty-fifty starting point when dividing the marital property. The starting point of an equal division could be adjusted after considering the evidence regarding the *four* factors in paragraphs (c)(2) through (c)(5).[35] In addition, the court of appeals in *Luedke* found a "rebuttable presumption" in paragraph (c)(1) that the contribution of the homemaker is equal to that of the wage earner.[36] The amended Indiana Code section 31-1-11.5-11(c)(1) has no specific presumption. The practitioner must ask whether there is any substantive difference between the amended statute and the *Luedke* opinion of the court of appeals. Clearly, both the amended statute and the court of appeals opinion in *Luedke* start with a fifty-fifty division of marital property. The amended statute allows the parties to rebut the presumption of a fifty-fifty division by providing evidence relevant to the five factors listed in Indiana Code section 31-1-11.5-11(c).[37] The *Luedke* opinion of the court of appeals called for an equal division of marital property where one spouse was the bread-winner and the other the homemaker and the other four factors in Indiana Code section 31-1-11.5-11(c) were equal.[38] If, however, one spouse had neglected his or her role as breadwinner or homemaker, the mandate for equality in the division disappeared.[39] Therefore, the substantive difference between the amended property division statute and the court of appeals opinion in *Luedke* rests in the absence of any direction from the legislature to the trial court as to how to apply subparagraph (c)(1) of Indiana Code section 31-1-11.5-11.

To illustrate the problem, assume the following facts are before the trial court. John Doe earns $25,000 per year working for Big Company, Inc. Jane Doe, John's wife, earns $25,000 per year at Giant Enterprises, Inc. Each spouse has worked throughout the marriage and earned equal

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[32]IND. CODE § 31-1-11.5-11(c) (Supp. 1987).

[33]*Id.*

[34]*Id.*

[35]476 N.E.2d at 865.

[36]*Id.* at 864-65.

[37]IND. CODE § 31-1-11.5-11(c) (Supp. 1987).

[38]*Luedke*, 476 N.E.2d at 859-60.

[39]*Id.*

amounts. Neither spouse inherited any property and neither received any property by gift. Neither spouse dissipated any assets. Each spouse has the same earning ability and each has the same prospective economic circumstances. The only relevant difference between them is that the husband did very little at home and wife did most of the homemaking chores. Given these facts, must the trial judge divide the marital property equally or must Jane receive more than John because of her non-income producing contributions (homemaking activities)?

Indiana Code section 31-1-11.5-11(c) requires the trial court to presume an equal division unless the presumption is rebutted by evidence regarding the five factors in paragraphs (c)(1) through (c)(5).[40] Looking at the evidence, the only difference between the parties is Jane's "extra" contribution of homemaking activities. The judge must grapple with the question of whether Jane has rebutted the presumption of an equal division because of her homemaking contribution. If she has, then Jane should receive more than fifty percent of the marital property.

In *Temple v. Temple*,[41] the wife appealed the trial court's property division alleging that the court had failed to recognize her contribution as a homemaker and wage earner.[42] The wife had worked full-time or part-time and at all times she was the primary homemaker.[43] The court of appeals affirmed the trial court's division which awarded the wife more than fifty percent of the property.[44] Regarding the wife's dual contributions, the appellate court stated as follows:

> Wife made a contribution to the acquisition of the property as a wage earner *and* homemaker. Thus, contrary to *Patus*, we find the statutory mandate to consider the contribution of each spouse to the acquisition of the marital property, including the contribution of a homemaker, is a recognition by the legislature that the homemaking endeavors of both spouses in a marriage have a marital value which contributes to the acquisition of marital property. There is no justification for limiting this factor exclusively to a non-wage earner, primary homemaking spouse. Rather, both functions, homemaking and wage earning, are considerations.[45]

In the vacated opinion of the court of appeals in *Luedke*, the appellate court recognized the "marital value" approach to homemaking contri-

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[40] *See supra* notes 4-5 and accompanying text.

[41] 435 N.E.2d 259 (Ind. Ct. App. 1982).

[42] *Id.* at 260.

[43] *Id.* at 262.

[44] *Id.* (the wife received sixty-nine percent of the assets).

[45] *Id.*

butions found in *Temple*.[46] "The 'marital value' approach to homemaker contributions recognizes the marriage as a voluntary association of co-equals, with implied equal rights, duties and contributions, in which the parties define, assign, and carry out their roles."[47] Thus, each spouse accepts the role assumed by the other spouse and accepts the contributions of each as equal.[48] Presumably, if one spouse did not accept the contribution of the other as equal, he or she could get out of the marriage.

Because the court of appeals' opinion in *Luedke* was vacated, there is little Indiana case law specifically discussing the problem of the spouse (or spouses) with dual contributions as a homemaker and as a wage earner. It would appear, however, that *Temple* would call for the trial court to divide John and Jane Doe's marital property equally between them.[49] Using the reasoning found in *Temple* the trial court would assume that each of the parties had accepted the other party's contribution as equal to his or her own contribution. Thus, with all of the other factors in Indiana Code section 31-1-11.5-11(c) being equal, the trial court would divide the property equally. At the trial, if Jane attempted to introduce evidence that she had done virtually all the work around the house and John had done very little, John would object to the introduction of this evidence citing *Temple* and *In re Marriage of Patus*.[50]

In *Patus*, the trial court divided the marital estate equally between the parties. The wife appealed alleging the trial court erred because it failed to award her more than fifty percent where the evidence showed she had been an equal wage earner during the marriage as well as a homemaker.[51] The court of appeals affirmed the trial court's division of property.[52] In so doing, the appellate court found the legislature's intent in Indiana Code section 31-1-11.5-11(c)(1) was to allow for circumstances where:

> (1) one spouse is not employed outside the home,
> (2) that the unemployed spouse is *solely* a homemaker, and
> (3) that the unemployed, homemaking spouse is the *primary* homemaker.[53]

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[46]Luedke v. Luedke, 476 N.E.2d 853, 864 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985).

[47]*Id.* In contrast with the "marital value" approach is the "market value" approach in which the homemaker spouse's services are valued at the market price required to purchase labor to perform the various household chores. *Id.* at 863-64, n.11.

[48]*Id.* at 860, n.6.

[49]*See* Temple v. Temple, 435 N.E.2d 259 (Ind. Ct. App. 1982).

[50]175 Ind. App. 459, 372 N.E.2d 493 (1978).

[51]*Id.* at 460, 372 N.E.2d at 495.

[52]*Id.*

[53]*Id.* at 461, 372 N.E.2d at 495.

The court of appeals refused to interpret the statute in a manner which would call for a "detailed inquiry into the private activities of the home."[54] The appellate court justified its interpretation as follows:

> When each marital partner brings earnings into the marriage, and those earnings are substantially equal, we do not believe that an exhaustive examination of who washed dishes, who took out the trash, who painted the house, who changed the oil in the car, who changed the diapers, who paid the bills, and who mowed the lawn is constructive. Of course, there may be extreme circumstances in which one partner makes virtually no homemaking contribution, but that was not the case in the Patus home.
>
> We decline to encourage trial courts, by reweighing evidence on appeal, to elicit volumes of self-serving testimony regarding homemaking contributions; the "no-fault" system of divorce would be lost in the mire of who-did-what for the home. The judgment of the trial court will be reversed only for a clear abuse of discretion. The earnings of the parties were reliable indices of the relative contributions to the acquisition of marital property. No abuse was demonstrated in the trial court's "50/50" division of property.[55]

As discussed earlier, the court of appeals in *Temple* disagreed with the interpretation of the statute in the *Patus* case.[56] Looking at both cases, it appears that each calls for an extremely limited review, if any, of the homemaking activities of either spouse. With this precedent, the effect of the amended Indiana Code section 31-1-11.5-11(c) is unclear. The new language in subsection (c) requires an equal division of property between the spouses unless there is evidence presented relevant to the five factors in subsection (c) which *rebuts* the fifty-fifty division.[57] The amended statute should allow the parties to present evidence of any "non-income producing" contributions (presumably including homemaking contributions) pursuant to Indiana Code section 31-1-11.5-11(c)(1). Therefore, any interpretation of *Temple* and *Patus* which would prevent a party from introducing evidence of homemaking contributions would be contrary to the new amended statute. A question remains, however, as to the extent to which a party can present evidence of what chores he or she did around the home. Again, the reasoning and analysis of

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[54]*Id.* at 462, 372 N.E.2d at 496.
[55]*Id.*
[56]Temple v. Temple, 435 N.E.2d 259 (Ind. Ct. App. 1982).
[57]Ind. Code § 31-1-11.5-11(c) (Supp. 1987).

the opinion of the court of appeals in *Luedke* may provide guidance.

In *Luedke*,[58] the court of appeals rejected the limited view of the homemaking contributions taken by the appellate court in *Patus*[59] in favor of the broader view in *Temple*.[60] The court reasoned that the view taken in *Patus* would write paragraph (c)(1) out of the property division statute where a spouse contributes both as a wage earner and as a homemaker.[61] The court adopted the "marital value" approach to homemaking contributions as discussed in *Temple* but went further to find a rebuttable presumption that the contribution of the homemaker is equal to the contribution of the wage earner.[62] The court reasoned that the presumption of equal contribution recognizes "the reality of the marriage relationship as a common enterprise, a voluntary union of co-equals in which the parties define and agree upon their roles."[63] The court also stated as follows:

> The presumption of equal distribution avoids these problems by recognizing as paramount the agreement of the parties to their role in the marriage, whatever the socioeconomic characteristics of the particular household. The presumption also accounts for the intangible yet beneficial contributions the homemaker makes to the marriage, and it eliminates the time and expense necessary for presentation of volumes of evidence, including expert testimony, of "who-did-what" for the marriage. In addition, the presumption of equal division implicit in paragraph 11(b)(1) serves to focus the litigation on the remaining factors in subsection 11(b) thus directing the trial court's attention to the more concrete considerations involving specific, identifiable property (paragraphs 11(b)(2) and (4)) and economic matters generally susceptible of direct proof (paragraphs 11(b)(3) and (5)).[64]

Returning to John and Jane Doe's case, questions still remain. Should the trial judge allow Jane to introduce the evidence of her homemaking contributions? If he does allow the evidence, must Jane receive more than an equal division of the marital estate? Given the opening language of the amended Indiana Code section 31-1-11.5-11(c), Jane should be

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[58]Luedke v. Luedke, 476 N.E.2d 853 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985).

[59]*In re* Marriage of Patus, 175 Ind. App. 459, 435 N.E.2d 259 (Ind. Ct. App. 1982).

[60]Temple v. Temple, 372 N.E.2d 493 (1978).

[61]*Luedke*, 476 N.E.2d at 863.

[62]*Id.* at 864-65.

[63]*Id.* at 866.

[64]*Id.* At the time of the opinion, subsection (c) of Indiana Code Section 31-1-11.5-11 was subparagraph (b).

allowed to introduce evidence of her contribution as a homemaker and as a wage earner. If the trial court prohibited her from introducing this evidence, Jane would be left without the ability to rebut the presumption of an equal division which is contrary to the explicit language of Indiana Code section 31-1-11.5-11(c).[65] Also, Jane should be allowed to show she has made a contribution under Indiana Code section 31-1-11.5-11(c)(1) in order to prevent John from receiving the benefit of the presumption. Jane, however, should not be able to drone on for hours going over the individual jobs she had done during the marriage—the self-serving "who-did-what" evidence. Looking at *Patus*,[66] *Temple*,[67] and the vacated opinion of the court of appeals in *Luedke*[68] the appellate courts likely will place some kind of limit on the "who-did-what" evidence. Now that the legislature has rejected the supreme court's view of the division of marital property, the reasoning of the court of appeals in *Luedke* becomes even more persuasive. Therefore, it may be safe to assume that Jane Doe's evidence regarding her non-income producing contributions is admissable to the extent that it is relevant to rebut the presumption of a fifty-fifty division of the marital estate. Eventually, the appellate courts may find the same kind of rebuttable presumption of equal contributions in paragraph (c)(1) of Indiana Code section 31-1-11.5-11 as the court of appeals did in *Luedke*. Thus, the contributions of each spouse would be presumed equal even if one spouse made both financial contributions and non-income producing contributions. The only relevant circumstances would be when one spouse totally neglected his or her role in the marriage.

The courts must deal with conflicting policy considerations which have been expressed through case law and through the amendments to the property division statute. On the one hand, the trial court is mandated to presume that an equal division of marital property is "just and reasonable." Each spouse can introduce evidence relevant to the five statutory factors in an attempt to rebut that presumption.[69] One of the considerations is a spouse's non-income producing contribution. If the evidence regarding every other factor is equal, then in order to reach a "just and reasonable division," the spouse who made dual contributions under Indiana Code section 31-1-11.5-11(c)(1) should receive more of the marital estate. On the other hand, from a practical perspective, the final hearing of a dissolution of marriage petition cannot become a

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[65]*See* IND. CODE § 31-1-11.5-11(c) (Supp. 1987).

[66]*In re* Marriage of Patus, 175 Ind. App. 459, 372 N.E.2d 493 (1978).

[67]Temple v. Temple, 435 N.E.2d 259 (Ind. Ct. App. 1982).

[68]Luedke v. Luedke, 476 N.E.2d 853 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985).

[69]IND. CODE § 31-1-11.5-11(c)(1)-(5) (Supp. 1987).

forum for a recounting of each and every job and chore a spouse performed during the marriage. Appellate courts should attempt to limit the scope of this kind of evidence in a method similar to the "rebuttable presumption" the court of appeals found in Indiana Code section 31-1-11.5-11(c)(1) in its vacated *Luedke* opinion.[70] The trial court would presume an equal contribution by both spouses in paragraph (c)(1). As part of the presumption, the court would presume that whatever roles the parties had assumed during the marriage, it was with the other's approval or acquiesence. Thus, the only "who-did-what" evidence that would be relevant would be to rebut that presumption. At some point in time, however, the policy makers may have to look at the factors in Indiana Code section 31-1-11.5-11(c) to examine whether the spouse who is employed *and* does all (or virtually all) the homemaking chores is being adequately compensated for that dual contribution. The social impact of the "two-paycheck" family may call for further refinement of Indiana's property division statute.

Family law practitioners may find that the amendments to Indiana Code section 31-1-11.5-11(c) will affect their clients in other ways. Because of the statutory presumption of an equal division of the marital estate, more clients may be unwilling to settle for a division which varies from the fifty-fifty division. More clients may wish to "gamble" in court and take their chances with the judge following the equal division presumption, especially where large inheritances or short-term marriages are involved. Thus, the amendments may actually increase rather than reduce the number of contested trials.

III. *Martin v. Martin*: Educational Expense Orders

During the survey period, the Indiana Supreme Court seized an opportunity to clarify Indiana's law regarding a divorced parent's obligation for his child's college expenses beyond the child's twenty-first birthday. In *Martin v. Martin*[71] the supreme court vacated the court of appeals' decision and held that if an educational needs support order existed prior to the child's twenty-first birthday, that order could be enforced and/or modified even after age twenty-one.[72] Both the supreme court and the court of appeals reached the same result, reversing the trial court's finding that no prior education order existed, and thus no education order could be extended beyond age twenty-one.[73] Contrary to the trial court's findings, both the supreme court and the court of

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[70] 476 N.E.2d 853 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985).
[71] 495 N.E.2d 523 (Ind. 1986).
[72] *Id.* at 525.
[73] *Id.* at 523-24.

appeals found a prior existing educational needs order which allowed both appellate courts to reverse the trial court. What makes this case noteworthy is the reasoning and analysis of the appellate courts in their respective opinions using the same set of facts as the trial court.

Gaye Martin (mother) and Harold Martin (father) were divorced on May 29, 1974. The parties had two daughters. When the older daughter married, Rebecca's (the younger daughter's) support was fixed at $22.50 per week. After graduation from high school, Rebecca enrolled and attended Northwestern University. Upon her twenty-first birthday (November 24, 1982), her father stopped paying support.[74] On January 26, 1983 the mother filed her petitions with the trial court seeking enforcement of the prior support order and modification of the order to increase the amount to help defray Rebecca's college expenses.[75] At the hearing on the petitions, the trial court found that the father's duty of support terminated on Rebecca's twenty-first birthday. The trial court also found that because no order for educational expenses existed prior to Rebecca's twenty-first birthday, no such order could be entered subsequent to that date.[76] Rebecca appealed the trial court's decision.

On appeal, the court of appeals rebuked the father's contention that under Indiana case law an order for a child's education expenses terminates when the child reaches age twenty-one.[77] Citing Indiana Code section 31-1-11.5-12, the court of appeals stated that a parent's obligation for a child's educational expenses may continue beyond the child's twenty-first birthday.[78] The court of appeals then considered "whether or not there must be an order for educational expenses in existence prior to the child's twenty-first birthday in order for such order to continue beyond that time."[79]

Looking at the existing support order for Rebecca, the court of appeals found that it provided for educational expenses even though there was no "separate and distinct" order for educational needs.[80] Relying on its earlier opinion in *Howard v. Reeck*,[81] the court of appeals found the support order at issue to include education expenses because "I.C. 31-1-11.5-12 includes educational expenses as an element of support as opposed to a separate and distinct award or allowance."[82] Apparently,

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[74]*Id.* at 525.

[75]*Id.*

[76]487 N.E.2d 1321, 1322 (Ind. Ct. App.), *vacated*, 495 N.E.2d 523 (Ind. 1986).

[77]*Id.* at 1323.

[78]*Id.* (citing Thiele v. Thiele, 479 N.E.2d 1324 (Ind. Ct. App. 1985)).

[79]*Id.*

[80]*Id.*

[81]439 N.E.2d 727 (Ind. Ct. App. 1982).

[82]Martin v. Martin, 487 N.E.2d 1321, 1323 (quoting, *Howard*, 439 N.E.2d at 730), *vacated*, 495 N.E.2d 523 (Ind. 1986).

according to the court of appeals, any support order necessarily included educational expenses and no "separate and distinct"[83] order need exist. Therefore, Rebecca had a prior educational expenses order which could continue beyond age twenty-one.[84]

Within seven months after the court of appeals issued its decision, the Indiana Supreme Court granted transfer and vacated the lower appellate court's opinion.[85] The supreme court, however, did not disagree with the result reached by the court of appeals. The supreme court did not disagree with the appellate court's finding that an educational expenses order can continue beyond the child's twenty-first birthday. The supreme court did, however, provide more analysis of the issue.

The supreme court first looked to the governing statute—Indiana Code section 31-1-11.5-12.[86] Justice Dickson, writing for the court, provided the following review of the statute:

> The statute enumerates two exceptions to the provision that child support duties cease when the child reaches twenty-one. The first exception is emancipation before 21, and the second exception applies where the child is incapacitated. It is within the first exception that we find the crucial language:
>
> "[h]owever, an order for educational needs may continue in effect until further order of the court."
>
> While this provision is located within the exception applicable to emancipation prior to age 21, we do not limit its application to situations where a child is emancipated before 21. We will not attribute to the legislature an intention to create a special

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[83]487 N.E.2d at 1323.

[84]*Id.*

[85]495 N.E.2d 523 (Ind. 1986).

[86]The relevant provisions read as follows:

> (a) In an action pursuant to [dissolution or child support], the court may order either parent or both parents to pay any amount reasonable for support of a child, ...
>
> (b) Such child support order may also include, where appropriate:
>
> (1) sums for the child's education in schools and at institutions of higher learning, taking into account the child's aptitude and ability and the ability of the parent or parents to meet these expenses; . . . .
>
> (d) The duty to support a child under this chapter *ceases* when the child reaches his twenty-first birthday *unless*:
>
> (1) the child is emancipated prior to his twenty-first birthday in which case the child support, except for education needs, terminates at the time of emancipation; however, an order for educational needs *may continue* in effect until further order of the court; or
>
> (2) the child is incapacitated in which case the child support continues during the incapacity or until further order of the court. IND. CODE § 31-1-11.5-12 (1982) (emphasis added).

> privilege for children who are emancipated before age 21. Furthermore, under such a restrictive interpretation, the above-quoted language would be mere surplusage. The immediately preceding phrase clearly allows education support to continue notwithstanding emancipation before age 21. Thus, for the statutory language to be meaningful, we must construe it to permit educational support beyond the cessation of the general duty to support a child, regardless whether the cessation is at age 21 or by reason of prior emancipation.[87]

Justice Dickson further found that the statutory provision regarding educational expenses specifically states that such an order "may continue" and does not state that it may be first initiated after age twenty-one. He stated:

> The statute does not authorize adult children to use post-dissolution proceedings to finance the expenses of college commenced or resumed later in life. If this had been the intention of the General Assembly, we presume that the enacted statute would have so provided. It does not. The statutory language is clear. Where educational needs are expressly included in a support order enacted prior to a child's emancipation or attaining age 21, the trial court is authorized to continue to address such educational needs.[88]

Finally, the supreme court noted that Indiana Code section 31-1-11.5-17 expressly permits a modification of a child support order. Therefore, not only can an order for educational expenses continue beyond age twenty-one, it may be modified after age twenty-one.[89]

Looking at the order regarding Rebecca, the supreme court found that it encompassed her educational needs although no separate and distinct provision existed.[90] The court looked to a July 17, 1977, modification order in which the trial court found that the older daughter had educational needs. The court inferred that the trial judge intended the same for both the older daughter *and* Rebecca. The supreme court found that specific reference to the oldest daughter's educational needs was sufficient for a finding that a prior education order existed for Rebecca.[91]

The lesson for the practitioner is clear. When drafting any support provision, make sure the issue of educational needs is specifically ad-

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[87] 495 N.E.2d 523, 525 (Ind. 1986).

[88] *Id.*

[89] *Id.*

[90] *Id.* at 525-26.

[91] *Id.*

dressed. Even if the parties cannot agree on who shall pay what, at least recite that there exists a need for educational expenses. The court of appeals in *Martin*[92] apparently found any support order to encompass educational expenses. The supreme court in *Martin*[93] searched for a specific reference to educational needs. The practitioner cannot rely on a future court to make that same kind of search.

IV. *Franklin Bank and Trust Company v. Reed*: Securing Future Property Settlement Payments

In late 1986, the court of appeals issued an opinion which directly addressed the issues in a case involving future property settlement payments from one spouse to the other over an extended period of time. Generally, the trial court's decision to provide (or *not* to provide) security for property division payments over a period of time is discretionary.[94] The appellate courts will reverse a decision only if an abuse of discretion is shown.[95] For example, in *Johnson v. Johnson*,[96] the court of appeals reversed the trial court's order forcing the entire marital estate to be liquidated and placed in trust for the support of the wife and children. The appellate court found that the order went beyond merely providing security and that it failed to effect a "financial parting of the ways."[97]

In *Wilson v. Wilson*,[98] the court of appeals affirmed the trial court's failure to provide security for payments equal to $60,500 spread over 121 months. In an earlier case, *In re Marriage of Davis*,[99] the court of appeals discussed the broad discretion of the trial court in its decision to provide security. The court stated:

> The statutory language obviously affords the court the broadest possible discretion in requiring security for the payment of support and the division of marital property. As we have made clear throughout this opinion, we will not substitute our judgment for that of the trial court. Neither will we impose a greater obligation upon the trial court to require security than the legislature has imposed. We are troubled by the fact that Bonnie was dispossessed of her holdings - a little less than one-half of

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[92]Martin v. Martin, 487 N.E.2d 1321, 1322 (Ind. Ct. App.), *vacated*, 495 N.E.2d 523 (Ind. 1986).

[93]Martin v. Martin, 495 N.E.2d 523 (Ind. 1986).

[94]Wilson v. Wilson, 409 N.E.2d 1169, 1175 (Ind. Ct. App. 1980).

[95]*Id.*

[96]460 N.E.2d 978 (Ind. Ct. App. 1984).

[97]*Id.* at 979.

[98]409 N.E.2d 1169, 1175 (Ind. Ct. App. 1980).

[99]182 Ind. App. 342, 395 N.E.2d 1254 (1979).

> the total stock outstanding - in exchange for certain valuable property and $100,000.00 payable over 130 months. We question the wisdom of giving an unsecured, personal debt in exchange for such assets, but, in light of the statutory provisions and the evidence before the trial court, we are unable to deem it an abuse of discretion.[100]

Thus, if the trial court failed to provide security for future payments that decision would likely be affirmed on appeal. When advising a client on the terms of a settlement which provides for future payments, the attorney must keep in mind that should the issue come before the trial court, there are no guarantees that the client will get that security.

In *Franklin Bank and Trust Co. v. Reed*[101] the court of appeals reversed the trial court's finding that the ex-wife, Ruth Reed, had a prior, superior security interest in real estate owned by her ex-husband as to the bank which received the real estate from the ex-husband in satisfaction of his debts. In the original dissolution action, the trial court awarded Ruth a property settlement judgment against her ex-husband in the sum of $170,000 to be paid over six years. The trial court made no specific finding that the judgment was to be a lien on the real estate of the husband. Ruth recorded a certified copy of her judgment in Johnson County (where the land at issue was located) on February 23, 1981. The ex-husband, on December 5, 1981, transferred title of the property to the bank.[102] The issue before the court of appeals was deceivingly simple. Was Ruth's judgment a lien on the Johnson County property? If so, was it superior to the bank's interest?[103]

Ruth argued that a judgment lien existed because of the general lien statute, Indiana Code section 34-1-45-2[104] and, therefore, she was entitled to priority over the bank who received title subsequent to the recordation

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[100]*Id.* at 350, 395 N.E.2d at 1259 (footnote omitted).

[101]496 N.E.2d 596 (Ind. Ct. App. 1986), *vacated*, 508 N.E.2d 1256 (Ind. 1987).

[102]496 N.E.2d at 598.

[103]*Id.*

[104]All final judgments for the recovery of money or costs in the circuit court and

> other courts of record of general original jurisdiction sitting in the state of Indiana, whether state or federal, shall be a lien upon real estate and chattels real liable to execution in the county where, and only where, such judgment has been duly entered and indexed in the judgment docket as provided by law, from and after the time the same shall have been so entered and indexed, and until the expiration of ten (10) years from the rendition thereof, and no longer, exclusive of the time during which the party may be restrained from proceeding thereon by any appeal or injunction or by the death of the defendant, or by agreement of the parties entered of record.

IND. CODE § 34-1-45-2 (1982).

of her judgment.[105] The bank argued that Indiana Code section 31-1-11.5-15[106] controlled *exclusively* and, thus, because the trial court made no specific award of a lien, no lien existed.[107] The court of appeals agreed with the bank and held that the trial court has the option to create a lien or negate such a lien.[108] If the court is silent, no lien attaches because Indiana Code section 31-1-11.5-15 is exclusive.[109] Therefore, if no specific lien was awarded, the judgment was completely unsecured.

Approximately ten months after the court of appeals issued its opinion, the Indiana Supreme Court granted transfer and vacated the lower appellate court's decision.[110] Justice Pivarnik, writing for the court, reviewed the parties' contentions as follows:

> It is the Bank's contention that the marriage dissolution section, Ind. Code § 31-1-11.5-15, governs this matter exclusively and since the trial court failed to establish a lien, none exists. Ruth's contention is that a judgment lien exists by virtue of the general lien statute, Ind. Code § 34-1-45-2 and therefore she is entitled to priority over any interest obtained by the Bank as a result of Owen's subsequent assignment of his equitable interest in the Alexander property. Ruth reasons that prior to the advent of the new dissolution act, the prior act, Ind. Code § 31-1-12-17 (Burns 1973), expressly obviated the applicability of a judgment lien on money judgments paid by installments unless the court specifically created such a lien. However, the new dissolution statutes do not contain this prohibition. She urges that Ind. Code § 31-1-11.5-15 was noticeably shorn of that negative language, thus giving rise to the interpretation that the Legislature intended to allow a judgment to apply automatically unless a lower court, through its inherent power, eliminated the lien. Therefore, Ruth reasons the judgment lien statute and the dissolution statute are complementary and should not be interpreted as mutually exclusive. We agree with this interpretation of the above statutes.[111]

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[105]*Franklin Bank*, 496 N.E.2d at 598.

[106]Upon entering an order pursuant to section 11 or 12 of this chapter, the court may provide for such security, bond or other guarantee that shall be satisfactory to the court to secure the obligation to make child support payments or to secure the division of property. Ind. Code § 31-1-11.5-15 (1982).

[107]*Id.*

[108]*Id.* at 602.

[109]*Id.*

[110]508 N.E.2d 1256 (Ind. 1987).

[111]*Id.* at 1258.

In reaching its conclusion, the supreme court reviewed the holding of a 1985 probate case, *Bell v. Bingham*.[112] The court of appeals in *Bell* affirmed the trial court's grant of summary judgment in favor of the sole heir of Mary Bell against the claim by Mary Bell's ex-husband that he was a secured creditor of Mary's estate because of his "alimony" judgment.[113] The appellate court held that the dissolution court exercised its discretionary powers pursuant to Indiana Code section 31-1-11.5-15 by withholding a lien on a particular piece of real estate.[114] The dissolution court had awarded Mary the real estate and found that the husband, Olin, should "have no further interest in said real estate located at 623 or 625 Adams whatsoever."[115] The court of appeals found that the language of the dissolution court withheld a lien from Olin.[116]

The supreme court, in *Franklin Bank*,[117] relied upon the same reasoning. Justice Pivarnik stated as follows:

> It is clear the Legislature intended Ind. Code § 31-1-11.5-15 to give the dissolution court power to enforce its orders providing for division of the parties' property by ordering security bond or other guarantee. The court has many forms of security from which to choose in order to protect one or the other of the parties in their share of the property and yet sever the relationship of the parties to each other. The court also has the power to completely sever the interests of the parties in each other's share including any lien interest arising under Ind. Code § 34-1-45-2. Since § 34-1-45-2 is general in its application, however, giving a judgment lien to one obtaining a judgment in any action, such a lien is not automatically eliminated by the dissolution statute. Rather, the dissolution statute gives the court authority to overcome the judgment lien, or to augment it, or to limit it. But silence of the court does not eliminate the automatic provision in the judgment lien statute. The court may exercise its inherent power and eliminate a judgment lien only by positive action. There was no such action here.[118]

The supreme court disagreed with the appellate court's determination that Indiana Code section 34-1-45-2 and Indiana Code section 31-1-11.5-15 are mutually exclusive.[119] If a spouse is awarded a judgment, payable

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[112]484 N.E.2d 624 (Ind. Ct. App. 1985).
[113]*Id.*
[114]*Id.* at 627.
[115]*Id.*
[116]*Id.*
[117]508 N.E.2d 1256 (Ind. 1987).
[118]*Id.* at 1259.
[119]*Id.*

over a period of time, that judgment will automatically create a lien on any real estate of the obligated spouse *unless* the trial court specifically withholds that lien.

Franklin Bank contains several lessons. First, the attorney must make the trial court aware of the necessity of providing security for any future payments. Mrs. Reed may have been left out in the cold if the trial court had not awarded her a "judgment." If the language in the decree simply ordered the husband to pay her $10,000 a year for so many years there would have been a real issue as to whether any lien would attach. The attorney must make the trial court aware of the problem. Second, the language regarding security should be clear. Why be silent when the decree could specifically award a lien on a certain piece of real estate? If that piece of real estate is in a county different from the dissolution court, the attorney should record a certified copy of the decree in that county where the land is located in order to perfect the lien.

Third, given the language in *Bell*,[120] the clause in the decree or settlement agreement which releases the rights of the obligee spouse should not be so broad as to negate the automatic judgment lien. For example, if the clause in the decree or agreement provides that "Husband shall have all right, title and interest in the real estate located at 1910 Main Street free and clear of any claim of Wife, whatsoever," and, later a clause awards the wife a judgment of $15,000, there is a good argument that no lien attaches. The better practice would be to specifically award the wife a judgment lien on the real estate at 1910 Main Street. Finally, *Franklin Bank* shows how important the security issue can be in a dissolution case. The attorney must avoid the trap set for the unwary who think the negotiations are finished when the pay-off terms are agreed upon. Anytime there are payments to a spouse over an extended period of time, the attorney must deal with the security issues. Failing to do that leaves the job half done.

V. Conclusion

The survey period included three significant developments in Indiana's family law. The 1987 Indiana General Assembly amended Indiana Code section 31-1-11.5-11 and created a presumption of equal division of marital property in a dissolution of marriage action. The legislature's action came after the Indiana Supreme Court had rejected the court of appeal's attempt to create the same kind of presumption of equal division in *Luedke v. Luedke*.[121] The amendment presents new opportunities for

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[120] Bell v. Bingham, 484 N.E.2d 624 (Ind. Ct. App. 1985).
[121] 487 N.E.2d 133 (Ind. 1985).

family law practitioners in representing their clients in dissolution proceedings.

The Indiana Supreme Court issued two opinions which effect the family law practitioner. In *Martin v. Martin*,[122] the supreme court attempted to clarify a confusing area of the law regarding educational needs orders. The court held that so long as an order existed prior to the child's twenty-first birthday which recognized the child's education needs, that order can be enforced and/or modified after age twenty-one.[123] In *Franklin Bank and Trust Company v. Reed*,[124] the supreme court interpreted two lien statutes to provide for an automatic lien on real estate of the payor when the trial court awards the payee a judgment even though no lien is specifically mentioned in the decree. Although this holding provides greater security for the payee, the automatic lien can cause problems for the payor in any subsequent real estate transactions.

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[122] 495 N.E.2d 523 (Ind. 1986).
[123] *Id.* at 525.
[124] 508 N.E.2d 1256 (Ind. 1987).

Indiana's New Health Care Consent Act: A Guiding Light for the Health Care Provider

William H. Thompson*

I. Introduction

Many seriously ill patients are incapable of making health care decisions on their own behalf because such factors as trauma, disease, pain, medication or senility interfere, at least temporarily, with their ability to approve or disapprove a course of medical treatment. However, a patient does not lose his[1] common law and constitutional rights simply because he is stricken with a debilitating infirmity. Unless there is a medical emergency,[2] the physician must still obtain valid consent before treating the patient. Often, the patient has lapsed into unconsciousness without giving any prior instructions or other evidence of consent and the doctor must seek consent from someone else. Inevitably, the question arises as to who may give legal consent to treat the patient.[3] Surprisingly,

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[1]The author has elected to use the masculine pronouns "him" and "his" for ease in presentation rather than a more awkward form showing applicability to both sexes. No other purpose is intended.

[2]Ind. Code § 16-8-3-2 (1982).

[3]Ind. Code § 16-8-3-1(a) (Supp. 1986) (current version at Ind. Code §§ 16-8-12-1 to -12 (Supp. 1987)) stated:

> (a) Consent to medical or surgical treatment of a person (referred to in this chapter as the "patient") incompetent to give such consent by reason of minority, medical incapacity, mental illness, mental retardation, senility, alcoholism, or addiction to narcotics or dangerous drugs may be given by the following persons, and such consent shall be binding on the patient and the patient's heirs, administrators, executors, and personal representatives:
>
> (1) If the patient is an unmarried unemancipated minor:
>
> (A) by one (1) parent having custody of such minor;
>
> (B) if there is no custodial parent, by the legal guardian of the minor; and
>
> (C) if the patient is a neglected child, by the agency of which the child has been made a ward of the juvenile court.
>
> (2) If the patient is an emancipated minor, by the patient.
>
> (3) If the patient is incompetent for a reason or reasons other than minority, and has been so adjudged by a court of competent jurisdiction, then by the legal guardian of the patient. If the patient has been committed to an appropriate facility, then by the superintendent of such facility in accordance with the procedures in section 3[16-8-3-3] of this chapter.

little judicial or legislative attention has been paid to the problem of who is authorized to give consent for the incapable patient and less surprisingly, the practice varies considerably from state to state.[4]

Indiana's new Health Care Consent Act,[5] effective April 24, 1987, provides statutory authority by which capable individuals may delegate to others the power to make health care decisions on their behalf in the event of their incapacity. In addition to this "proxy consent" provision, the Act codifies two other forms of consent to health care, "substituted consent," and "delegated consent by relatives."[6] The Act also codifies the common law doctrine of when consent to one's own health care is valid consent.[7] The Act, patterned after the Uniform Law Commissioner's Model Health Care Consent Act,[8] takes an important step in furthering the individual's right to self-determination and autonomy through constitutional safeguards that are procedural in nature and which are not intended to affect the substantive areas of consent law. The Act purportedly is not designed to provide answers for the extraordinary cases, such as treatment of terminal illness, organ donation, or the treatment of mental illness; however, such situations as withdrawal of or withholding life-supportive measures may fall within the Act's coverage. Rather, it is written to provide guidance and assistance in the consent cases that occur daily and routinely in medical practice. In that sense, the Indiana Act provides welcome guidance in an area of health law that can be both confusing and inconsistent in its interpretation.

The purpose of this Article is to examine the provisions of the new Health Care Consent Act and explore some of the many issues that are inherent in legislation of such magnitude and import. This Article will review the various provisions of the new consent law and provide practical guidance to the health care provider in the application of those provisions. The interaction of Indiana's Living Wills and Life-Prolonging Procedures Act[9] with the new law also will be analyzed.

II. Consent to One's Own Health Care

It has long been recognized that a competent adult has the right to accept or refuse medical treatment.[10] This right is founded in the common

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[4]Meisel & Kabnick, *Informed Consent to Medical Treatment: An Analysis of Recent Legislation*, 41 U. Pitt. L. Rev. 407, 461-66 (1980).

[5]Ind. Code §§ 16-8-12-1 to -12 (Supp. 1987).

[6]*Id.* §§ 16-8-12-5 to -6.

[7]*Id.* § 16-8-11-1.

[8]Model Health Care Consent Act (Uniform Law Commissioners) (1982).

[9]Ind. Code § 16-8-11-1 to -13 (Supp. 1987).

[10]*See* Bouvia v. Superior Court, 179 Cal. App. 3d 1127, 225 Cal. Rptr. 297 (1986);

law of trespass and battery,[11] which serves to protect a person's interests in the integrity of his body and freedom from unauthorized physical contact. The right also finds support in the emerging common law doctrine recognizing an individual's right to self-determination. These common law doctrines have been reinforced by a series of cases holding that the constitutional right of privacy is broad enough to encompass choices regarding medical treatment.[12] The Health Care Consent Act recognizes that constitutional right in section 2 by prescribing who may consent to his own health care.

Section 2 of Indiana's Health Care Consent Act restates the common law doctrine that competent individuals have the right to consent to their own medical care.[13] The section requires that adults be capable to give consent to their own health care for such consent to be valid.[14] It also provides that certain minors may consent to their own health care if the minor is:

> (A) emancipated [as determined by the common law];
> (B) at least fourteen (14) years of age, is not dependent on a parent for support, is living apart from his parents and is managing his own affairs;
> (C) married or has been married;
> (D) in the military service of the United States; or
> (E) authorized to consent to the health care by any other statute.[15]

While the law has long recognized capable adults' rights to consent to their own health care, the capacity of minors to consent to health care has long troubled health care providers. At common law, minors were presumed incompetent and therefore not permitted to make health

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Brophy v. New England Sinai Hosp., Inc., 398 Mass. 417, 497 N.E.2d 626 (1986); Superintendent of Belchertown State School v. Saikewicz, 373 Mass. 728, 370 N.E.2d 417, (1977); *In re* Quinlan, 70 N.J. 10, 40, 355 A.2d 647, 663 (1976) (constitutional right of privacy "broad enough to encompass a patient's decision to decline medical treatment under certain circumstances"), *cert. denied*, 429 U.S. 922 (1976); *In re* Yetter, 62 Pa. D. & C.2d 619, 623-24 (1973) (upholding the right of a state mental institution inmate to refuse surgery for breast cancer).

[11]*See* Schloendorff v. Society of New York Hospital, 211 N.Y. 125, 105 N.E. 92 (1914) (overruled on other grounds in Bing v. Thunig, 2 N.Y.2d 656, 163 N.Y.S.2d 3, 143 N.E.2d 3 (1957)) ("Every human being of adult years and sound mind has a right to determine what shall be done with his own body; and a surgeon who performs an operation without his patient's consent commits an assault, for which he is liable in damages.").

[12]*See* Doe v. Bolton, 410 U.S. 179, 213 (1973); Roe v. Wade, 410 U.S. 113, 153 (1973).

[13]IND. CODE § 16-8-12-2 (Supp. 1987).

[14]*Id.*

[15]*Id.* § 16-8-12-2(2)(A) to -(E).

care decisions.[16] However, over the years both statutory and common law exceptions have evolved that render a minor capable of giving valid consent to certain forms of medical treatment, e.g., consent to drug/alcohol abuse treatment,[17] blood donation,[18] venereal disease treatment,[19] and abortion.[20] These exceptions are based on public policy concerns about the spread of disease and the protection of a minor's confidentiality, as well as the policy of providing incentives for a minor to seek treatment. Further, the common law doctrine of emancipation has carved out exceptions to a minor's presumed incapacity to make health care decisions. These exceptions are based on the assumption that a minor who has made certain "adult-like" decisions or taken certain actions in his life has demonstrated capacity to make health care decisions.[21] The emancipation exceptions are recognized in section 2(2)(A) & (B) of the Act.[22]

Whereas section 2(2)(A) of the Act[23] embodies the traditional common law concept of emancipation, section 2(2)(B)[24] is an explicit emancipation provision based on objective criteria which will not require the provider to turn to common law or to a formal adjudication of emancipation before accepting consent. Accordingly, a health care provider should be protected if it accepts consent from minors who are at least fourteen, are not dependent on a parent, are living apart from parents, and are managing their own affairs. The age requirement of this section provides a statutory threshold above which a minor, if he meets the other criteria, may be presumed emancipated and may give valid consent to health care.[25] Otherwise, the adjudication of emancipation could be necessary if a minor is less than fourteen years of age and the health care provider

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[16]42 C.J.S. Infants § 108 (1978).

[17]Ind. Code § 16-13-6.1-23 (1982).

[18]Ind. Code § 16-8-2-1 (Supp. 1987).

[19]*Id.* § 16-8-5-1.

[20]Ind. Code § 35-1-58.5-2.5(b).

[21]*See* Model Health-Care Consent Act (Uniform Law Commissioners) § 2 comment (1982).

[22]Ind. Code § 16-8-12-2(2)(A), (B) (Supp. 1987).

[23]*Id.* § 16-8-12-2(2)(A).

[24]*Id.* § 16-8-12-2(2)(B).

[25]Ind. Code § 16-8-3-1(b)(1982) (rewritten 1986, amended 1987). This section provided that consent could be given "if the patient is an emancipated minor, by the patient; provided further, that if such minor be married, then his or her spouse shall join in such consent." *Id.* The new consent law does not require the emancipated minor's spouse to join in the consent. The law also provides additional criteria to determine whether a minor is emancipated, e.g., at least fourteen years of age, is not dependent on a parent for support, is living apart from the minor's parents or from an individual *in loco parentis*, and is managing the minor's own affairs. Ind. Code § 16-8-12-2 (Supp. 1987).

is not assured that the minor meets the common law criteria of emancipation.

III. Substituted Consent

Section 4 of the Act creates authority for certain persons to consent to health care on behalf of an incapable individual if no health care representative has otherwise been appointed under the Act.[26] In so providing, the legislature has now generally recognized the legal doctrine of "substituted consent." Substituted consent or substituted judgment is essentially a process whereby either the court or a surrogate act as the decision-maker for one who lacks such capacity.[27] Traditionally, the accepted practice among health care providers has been to obtain consent from the patient's spouse or next-of-kin, even though technically valid consent to medical treatment for an incompetent adult in Indiana could only be given by a court or the legal guardian of the patient after an adjudication of incompetency.[28] This has long been the law but seldom the practice. The Act now provides a priority list of those individuals, in addition to the courts and a legal guardian, who may exercise substituted consent on behalf of an incapable patient if no health care representative has otherwise been appointed under the Act.[29] This provision conforms with past practices of health care providers and as such provides a workable alternative to the judicial proceeding previously required under Indiana's consent law.[30] The persons who may give substituted consent for an incapable adult under the Act are:

(1) a judicially appointed guardian of the person;[31]
(2) a spouse, parent, adult child, *or* adult sibling; or[32]
(3) a religious superior.[33]

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[26]Ind. Code § 16-8-12-4 (Supp. 1987).

[27]*See* Superintendent of Belchertown v. Saikewicz, 373 Mass. 728, 370 N.E.2d 417 (1977).

[28]*See supra* note 3.

[29]Ind. Code § 16-8-12-4 (Supp. 1987).

[30]Ind. Code § 16-8-3-1 (Supp. 1986) (current version at Ind. Code §§ 16-8-12-1 to -12 (Supp. 1987)).

[31]Ind. Code § 16-8-12-4(a)(1) (Supp. 1987).

[32]*Id.* § 16-8-12-4(a)(2) (emphasis added). This provision does not purport to establish any priority between the individuals listed. Past practice of many health care providers when presented an incapable adult patient was to consult the spouse of the patient (if one existed) to obtain substituted consent. However, prior to the enactment of the Health Care Consent Act, only a legal guardian could make a binding consent decision on behalf of an incapacitated adult. Ind. Code § 16-8-3-1(c) (1982) (amended 1987). Thus, many procedures were performed every year without technically valid consent.

[33]Ind. Code § 16-8-12-4(a)(3) (Supp. 1987).

The persons who may give substituted consent for a minor are:

(1) a judicially appointed guardian of the person;

(2) a parent or person *in loco parentis; or*

(3) an adult sibling of the minor.[34]

In their role as surrogate decision-maker, the court or the individual to whom consent authority was delegated under section 4 is expected to make medical choices on behalf of the incapable patient in good faith and in the patient's best interest.[35] Accordingly, the substituted consent-giver must answer the question: What would this particular patient do if he could make the decision for himself? By requiring the decision-maker to put himself in the patient's shoes, this legal standard directs him to act "as if" he were the patient's agent. The decision-maker should be guided by his knowledge of the patient's own feelings and desires. Even though the incapable patient is no longer able to make legally controlling choices, any present expressions and wishes should be respected as much as possible. In addition, the surrogate may ascertain the patient's wishes by either assessing sentiments expressed by the patient prior to incapacity, or by drawing reasonable inferences from an examination of the patient's prior conduct.[36]

If it is impossible to ascertain the choice the patient would have made, then the surrogate decision-maker must do whatever is "in the patient's best interests." The "best interest" of the patient standard is generally thought to incorporate the concept of objective reasonableness—focusing on what would be wise, prudent or reasonable for the incapable patient to do, whereas a subjective substituted judgment standard will focus on the desires and preferences which the incapable person would have had except for his incapacity, given his present situation.[37]

As the President's Commission for the Study of Ethical Problems in Medicine and Biomedical and Behavioral Research suggested:

> In assessing whether a procedure or course of treatment would be in a patient's best interests, the surrogate must take into account such factors as the relief of suffering, the preservation or restoration of functioning, and the quality as well as the extent of life sustained. An accurate assessment will encompass consideration of the satisfaction of present desires, the oppor-

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[34]*Id.* § 16-8-12-4(b)(1) to -(3).

[35]*Id.* § 16-8-12-4(d).

[36]American Hospital Association, Office of General Counsel, Legal Memorandum Number 9, Discharging Hospital Patients: Legal Implications for Institutional Providers and Health Care Professionals, (June 1987) [hereinafter Discharging Hospital Patients].

[37]Fowler, *Appointing An Agent to Make Medical Treatment Choices*, 84 Colum. L. Rev. 985, 1003-4 (1984).

> tunities for future satisfactions, and the possibility of developing or regaining the capacity for self-determination.[38]

Ultimately, the standard against which the substituted decision-maker will be held will turn on the particular facts and circumstances of the individual case. In certain circumstances, health care providers may wish to seek legal counsel on whether a surrogate's action can withstand scrutiny under a "good faith" standard.

The priority list of consent-givers in section 4 raises another area of concern for health care providers—whether valid consent may be obtained when a disagreement exists between individuals in a particular category of consent-givers. For example, if the incapacitated patient's adult child exercises substituted consent to medical care under section 4(a)(2)[39] and the patient's spouse subsequently or concurrently disagrees with that consent, what are the options and obligations of the health care provider? The Act places no obligation upon the provider to obtain substituted consent from each individual in a particular category, nor are the individuals within the category listed in any order of preference. Accordingly, the health care provider obtains a valid consent if *any* individual within the category authorizes the treatment.[40] However, in the event of a dispute, the most conservative and safest course is to submit the issue to a court having probate jurisdiction for a decision based on the facts presented. At the very least, a health care provider should engage in further discussion among the parties to encourage a consensus opinion as to what treatment decision is in the best interest of the patient and document such decision and discussion in the patient's medical record. These judgment parameters should be embodied in institutional policy statements which delineate the appropriate circumstances leading to the acceptance of a surrogate decision-maker's substituted consent or to the initiation of a judicial proceeding. Until a legislative

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[38]President's Comm'n for the Study of Ethical Problems in Medicine and Biomedical and Behavioral Research, Deciding to Forego Life-Sustaining Treatment, (1983).

[39]Ind. Code § 16-8-12-4(a)(2) (Supp. 1987) provides that consent to health care of an incapable patient who has not otherwise appointed a health care representative may be given:

> (2) by a spouse, parent, adult child, or adult sibling unless disqualified under section 8 of this chapter, if:
>
> > (A) there is no guardian or other representative described in subdivision (1);
> >
> > (B) the guardian or other representative is not reasonably available or declines to act; or
> >
> > (C) the existence of the guardian or other representative is unknown to the health care provider.

[40]*See supra* note 26.

act determines a priority among those individuals authorized to exercise substituted consent, the health care provider must rely on the consistent application of sound judgment and clear policy should disagreements arise among authorized individuals.

A related issue concerns the duties and obligations of a hospital which arise when divorced parents disagree over the course of medical treatment that is appropriate for their minor child. Section 4(b)(2) of the Act clearly gives a parent the right to consent to health care for his or her minor child; however, it does not specify whether the parent must have physical or legal custody of the child to exercise such consent authority. Indiana Family law states:

> Except as otherwise agreed by the parties in writing at the time of the custody order, the custodian may determine the child's upbringing, including his education, *health care*, and religious training, unless the court finds, after motion by a noncustodial parent, that in the absence of a specific limitation of the custodian's authority, the child's physical health would be endangered or his emotional development significantly impaired.[41]

Therefore, it is clear that when a custody order has been issued by the court, the custodial parent has the final say in the course of medical treatment to be delivered to his or her child and may legally exercise consent. However, health care providers may be faced with the situation where the court has awarded joint legal custody of a child pursuant to Indiana law[42] and the parents disagree as to the appropriate course of medical treatment for the child. Although the Act is silent as to such a situation and "an award of joint legal custody does not require an equal division of physical custody of the child," as a practical matter, a health care provider is better advised to follow the wishes of the parent who has physical custody of the child at the time the health care decision is to be made than to seek consent from the parent not having present custody. Again, the hospital must be assured that the parent is acting in good faith and in the best interests of the child before obtaining such consent.

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[41] Ind. Code § 31-1-11.5-21(b) (Supp. 1986) (emphasis added).

[42] *Id.* § 31-1-11.5-21(f). This section provides:

> The court may award legal custody of a child jointly if the court finds that an award of joint legal custody would be in the best interest of the child. As used in this section, "joint legal custody" means that the persons awarded joint custody will share authority and responsibility for the major decisions concerning the child's upbringing, including the child's education, *health care*, and religious training. An award of joint legal custody does not require an equal division of physical custody of the child.

Id. (emphasis added).

Another interesting provision of section 4 is the consent authority it grants to one who stands *in loco parentis* to a minor.[43] Who is *in loco parentis*? Blacks Law Dictionary defines *in loco parentis* as "In the place of a parent; instead of a parent; charged, factitiously, with a parent's rights duties, and responsibilities."[44]

Indiana courts have addressed the issue of whether an individual stands *in loco parentis* to a minor in several cases.[45] Each judicial determination of whether an individual was *in loco parentis* turned on the factual circumstances of the case, with no clear guidelines emerging as to the determination of such a status.[46] Instead, the courts weighed the nature of the decision to be made by the individual alleged to be *in loco parentis* against the minor's constitutional protections and the public interest in such decisions being made by one other than the minor's parents.[47] The courts' decisions have ranged from finding that a teacher stands *in loco parentis* to students,[48] to finding that, absent strong indicia of a parental relationship, the *loco parentis* status will not be upheld.[49]

The Health Care Consent Act gives no definition of *in loco parentis* and as such, leaves the determination of the status to the health care provider. Although the Act provides no specific rule, the guidance that can be gleaned from the Act in making this determination is found in the many constitutional protections of an individual's right to self-determination and autonomy that permeate the other sections of the Act. Given these many statutory safeguards, it would follow that the status of *in loco parentis* should be construed narrowly. A finding of *in loco parentis* should be determined by the existence or nonexistence of an individual: "[w]ho has put himself in the situation of a lawful parent by assuming the obligations incident to the parental relation without going through the formalities necessary to legal adoption. It [the term *in loco parentis*] embodies the two ideas of assuming the

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[43]IND. CODE § 16-8-12-4(b)(2) (Supp. 1987).

[44]BLACK'S LAW DICTIONARY 896 (5th ed. 1979).

[45]*See* Swanson v. Wabash College, 504 N.E.2d 327 (Ind. 1987); Sturrup v. Mahan, 261 Ind. 373, 305 N.E.2d 877 (1970); Indiana State Personnel Bd. v. Jackson, 244 Ind. 321, 192 N.E.2d 740 (1965); Browder v. Harmeyer, 453 N.E.2d 301 (Ind. Ct. App. 1983); R.D.S. v. S.L.S., 402 N.E.2d 30 (Ind. Ct. App. 1980); Stout v. Tippecanoe County Dep't of Pub. Welfare, 182 Ind. App. 404, 395 N.E.2d 444 (1979); Bristow v. Konopka, 166 Ind. App. 357, 336 N.E.2d 397 (1975); Watson v. Department of Pub. Welfare, 130 Ind. App. 659, 165 N.E.2d 770 (1960); Kunkel v. Arnold, 131 Ind. App. 219, 158 N.E.2d 660 (1959).

[46]*See* cases cited *supra* note 45.

[47]*See* cases cited *supra* note 45.

[48]Indiana State Personnel Bd. v. Jackson, 244 Ind. 321, 192 N.E.2d 740 (1965).

[49]Sturrup v. Mahan, 261 Ind. 373, 305 N.E.2d 877 (1970).

parental status and discharging the parental duties."[50] It follows that a narrow construction of section 4 of the Act would prohibit a babysitter, teacher, camp counselor or similarly situated person from standing *in loco parentis* to a minor needing health care. Thus, the issue of whether a baby sitter, teacher, camp counselor or other similarly situated person stands *in loco parentis* to a minor needing health care would most likely be answered in the negative, given a narrow construction of the legal concept established under section 4 of the Act.

IV. Proxy Consent

Section 6 of the Act again extends the individual's right to self-determination and autonomy by permitting the appointment of another capable adult as a representative to make health care decisions on the appointor's behalf in the event of the appointor's incapacity.[51] The appointment must be in writing,[52] signed by the appointer or designee in the appointor's presence,[53] and witnessed by an adult.[54] The appointment becomes effective upon the appointor's incapacity[55] and is revocable by oral or written notification to the health care provider.[56] Furthermore, such a health care representative has priority to act over all others in matters affecting the appointor's health care.[57] This authority is governed by the express terms and conditions of the appointment and can thereby be limited at the direction of the appointor.[58]

The appointment of a health care representative places the authority to make decisions on behalf of the appointor in the hands of an individual whom the appointor himself has chosen. Traditionally, the authority to make health care decisions for an incompetent or incapable individual has been placed in the hands of a judicially appointed guardian or the courts.[59] The prior appointment of a representative by an individual to speak on the individual's behalf when he is no longer able to speak for himself significantly enhances the individual's control over his own medical care. At the same time, the appointment of a medical agent affords the treating physician the certainty of obtaining legally binding consent from a sole decision-maker without resorting to the courts. Proxy de-

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[50] R.D.S. v. S.L.S., 402 N.E.2d 30 (Ind. Ct. App. 1980).
[51] Ind. Code § 16-8-12-6 (Supp. 1987).
[52] *Id.* § 16-8-12-6(c)(1).
[53] *Id.* § 16-8-12-6(c)(2).
[54] *Id.* § 16-8-12-6(c)(3).
[55] *Id.* § 16-8-12-6(f).
[56] *Id.* § 16-8-12-6(j)(1).
[57] *Id.* § 16-8-12-6(g).
[58] *Id.* § 16-8-12-6(e).
[59] *See supra* note 3.

cision-making by an appointed representative is also more consistent with the tradition of informed consent in that the representative can help assure that an incapable patient receives treatment in accord with his own wishes. The recognition of proxy consent by the legislature now gives the health care provider firm ground on which to stand when seeking consent to treat a patient who lacks decision-making capacity. Equally important, patients may now choose which individuals will exercise consent on their behalf in the event of their incapacity.

The authority of a duly appointed health care representative under the Act is governed by the expressed terms of the appointment itself[60] and may only be further delegated by the representative if so specified in the written appointment.[61] Presumably, the representative possesses the same power and authority with respect to making health care decisions for the appointor as the appointor himself, except for the appointor's incapacity. However, the authority of the representative may be limited by the terms of the appointment. Furthermore, the representative must act "(1) in the best interest of the appointor consistent with the purpose expressed in the appointment; and (2) in good faith."[62] This standard is no different than the standard imposed on an individual authorized to exercise substituted consent under section 4 of the Act; therefore, it may be reviewed on either a subjective or objective basis as discussed previously.[63]

The "best interest" standard serves as a check and balance to the authority granted the health care representative. Most likely, any challenge to the health care representative's authority, absent acts contrary to the expressed terms of the appointment, will be made on the basis that the proxy consent decision is not in the best interest of the patient. This type of challenge can be handled the same way courts currently review the decision of a minor's parent or legal guardian to determine whether the patient's best interests are being served. The state, pursuant to its *parens patriae* authority, retains the power to intervene if a representative proposes to take steps plainly inconsistent with the welfare of the patient.[64] Accordingly, the health care provider is placed in a position of determining whether the surrogate decision-maker is acting in the patient's best interest. If it believes the surrogate is not acting consistent with the wishes and desires of the patient, then it has a duty to submit the

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[60]Ind. Code § 16-8-12-6(e) (Supp. 1987).

[61]*Id.* § 16-8-12-6(d).

[62]*Id.* § 16-8-12-6(h)(1) -(2).

[63]*See supra* notes 36-37 and accompanying text.

[64]*See generally In re* Quinlan, 70 N.J. 10, 355 A.2d 647 (1976), *cert. denied*, 429 U.S. 922 (1976); *In re* Boyd, 403 A.2d 744 (D.C. 1979) (the state must show a compelling state interest to override an adult patient's decision).

issue to the court. Again, this determination must be made based on the health care provider's good faith assessment of the patient's interests and the surrounding circumstances. The Act is not designed to keep all health care consent issues out of court, but instead, it is written to allow a patient to appoint a representative to act consistent with the patient's wishes and desires and in his best interest. Otherwise, the question may still require a judicial proceeding.

The "best interest" standard also raises issues with respect to the validity of a proxy decision-maker's consent to the withdrawal or withholding of life sustaining procedures. These issues will be discussed in section VII of this Article.

A. Incapacity and Procedural Safeguards under the Act

Pursuant to section 3 of the Act, the attending physician has the responsibility to determine whether a patient is capable of giving consent.[65] The appointment is executory in nature and therefore not effective until the appointor's attending physician has determined, in good faith, that the appointor is incapable of making a decision regarding the proposed health care.[66] It is important to note that the statute turns on the incapability or incapacity and not on the incompetence of a patient since a person may be *de jure* competent when in fact he is incapable of making a decision regarding his own health care. Additionally, the determination of incompetency usually involves a judicial proceeding. In contrast, section 3 of the Health Care Consent Act leaves the incapacity determination to the patient's attending physician's good faith opinion.

Health care professionals frequently disagree about how to evaluate a person who may be incompetent or incapable of making health care decisions on his own behalf. The fundamental principle that guides this inquiry is that "competence" relates to a patient's decision-making capacity rather than to his cognitive abilities. The question of competence or capacity should be approached from a "functional" standpoint which recognizes that regardless of the decision the patient ultimately makes or the clinical label attached to the patient, the key element is whether the patient is able to engage in rational decision-making.[67] The legislature has chosen "capacity" rather than "competence" to reflect its desire that the Act be a practical and workable guide, and that the decision

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[65] IND. CODE § 16-8-12-3(a) (Supp. 1987). "An individual otherwise authorized under this chapter may consent to health care unless, in the good faith opinion of the attending physician, the individual is incapable of making a decision regarding the proposed health care." *Id.*

[66] *Id.*

[67] *See* DISCHARGING HOSPITAL PATIENTS, *supra* note 36, at 8.

should be left to the attending physician, rather than the courts, absent contrary facts.[68]

It seems likely that the physician will be in the best position to determine the patient's capacity to make medical decisions on the patient's own behalf. Nevertheless, some critics fear the physician now has an incentive to judge the patient incapable quickly in order to obtain consent from a health care representative or other substitute consent-giver, although in truth, the patient may not meet a judicial definition of incompetence or incapacity. However, section 3(b) evidences the legislature's concern for personal autonomy and the protection of individual rights and serves as a safeguard against hasty determinations of incapacity. It states:

> A consent to health care under Section 4, 5, or 6 of this chapter [those authorized to give substituted consent] is not valid if the health care provider has knowledge that the individual has indicated contrary instructions in regard to the proposed health care, even if the individual is believed to be incapable of making a decision regarding the proposed health care at the time the individual indicates contrary instructions.[69]

In so providing, section 3(b) would allow an individual to express contrary instructions to those of the health care representative or substitute consent-giver even if the individual is of questionable capacity. The health care provider, who knows of such contrary instructions, must abide by those instructions and cannot accept consent from the surrogate. This section further recognizes the personal nature of health care decision-making and seeks to protect the individual's right to control his own medical treatment until it is clear, in the good faith opinion of the attending physician, that he is no longer capable of such decision-making. Any health care professional whose ethical or moral value system prevents him from carrying out the wishes of a patient should encourage and facilitate the patient's transfer to a health care professional who will respect and honor the patient's decision.

Section 8 of the Act is yet another procedural safeguard which allows a capable individual to specifically disqualify others from consenting to health care for the individual.[70] The disqualification may be made in the same instrument used to appoint a health care representative or it may be made in a separate document. The disqualification must be in

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[68] *See* Model Health-Care Consent Act (Uniform Law Commissioners) § 3 comment (1982).

[69] Ind. Code § 16-8-12-3(b) (Supp. 1987).

[70] *Id.* § 16-8-12-8.

writing, signed by the individual, and specifically identify those who are disqualified from exercising consent.[71] A health care provider who knows of a written disqualification may not accept consent to health care from a disqualified individual.[72] This section again shows the legislative intent to fully protect an individual's autonomy and constitutional right to privacy with respect to health care decisions.

Further safeguards for the individual are evidenced in section 6 which provides for easy revocation of an appointment of a health care representative.[73] The appointment is revocable by the appointor, when capable, by either oral or written notice to the representative or to the health care provider.[74] The health care representative may also resign or refuse to comply with the written appointment. In the latter event, the health care representative has a duty to inform the appointor,[75] the appointor's legal representative,[76] and the health care provider.[77] The representative may subsequently exercise no further power under the appointment.[78]

B. *Health Care Decisions and the Durable Power of Attorney*

The Health Care Consent Act provides authority specific to the delegation of health care decision-making power.[79] Even so, the health care provider may continue to face the question of the validity of a power of attorney to make the same type of treatment decisions. Several states have enacted legislation which explicitly or impliedly authorizes an individual to appoint an attorney-in-fact to make medical decisions in the event the principal subsequently becomes incapable.[80] In other states, as in Indiana, it has been argued that the Durable Power of Attorney statutes, which allow the authority of an agent to continue even where the principal becomes incapable, can be construed to authorize the agent to make health care decisions on behalf of the principal. Proponents point to the lack of language in the Durable Power of

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[71] *Id.* § 16-8-12-8(b).

[72] *Id.* § 16-8-12-8(c).

[73] *Id.* § 16-8-12-6(j).

[74] *Id.* § 16-8-12-6(j)(1) to -(2).

[75] *Id.* § 16-8-12-6(i)(1).

[76] *Id.* § 16-8-12-6(i)(2).

[77] *Id.* § 16-8-12-6(i)(3).

[78] *Id.* § 16-8-12-6(i).

[79] *Id.* §§ 16-8-12-5 to -6.

[80] *See, e.g.*, Del. Code Ann. tit. 16, § 2502(b) (1983); Cal. Civil Code § 2431(a) (West Supp. 1987); Va. Code Ann. § 54-325.8:1 (Supp. 1987); Fla. Stat. Ann. § 765.07(b) (West 1986); Iowa Code Ann. § 144 A.7 (West Supp. 1987-88); Tex. Health & Safety Code Ann. § 4590 h.3(e) (Vernon Supp. 1987).

Attorney statute prohibiting such a use as evidence that such use is possible, while opponents point to the lack of authorizing language as an indication that such use is invalid. Indiana courts have yet to consider the question.

Indiana's Durable Power of Attorney statute[81] does not enlarge the powers that may be given under a valid power of attorney. Indiana follows the general rule that a power of attorney may only grant the power to dispose of or deal with real or personal property.[82] As such, it does not explicitly or impliedly authorize the delegation of health care decision-making. Particularly, the Durable Power of Attorney statute does not contain the procedural and substantive safeguards that are present in the Health Care Consent Act. It would be unwise for an individual to use the Durable Power of Attorney vehicle to appoint an attorney-in-fact to make health care decisions on the individual's behalf, when section 6 of the Health Care Consent Act was enacted specifically for such a purpose. Attorneys and health care providers are well advised to rely on the specific authority granted by the Health Care Consent Act instead of risking the invalidity of a Durable Power of Attorney to delegate the principal's health care decision-making power to another individual in the event of the principal's incapacity.

V. Delegated Consent by Relatives

Section 5 of the Health Care Consent Act provides that a spouse, parent, adult child or adult sibling may delegate their substituted consent authority to another individual if, for a period of time, the person will not be reasonably available to exercise such authority.[83] Such a delegation must be in writing, signed and witnessed by an adult.[84] The designee cannot further delegate this authority unless specifically authorized in the instrument.[85] The designee has the same authority and responsibility as the delegant unless specifically limited in the written delegation.[86]

This provision could have utility in situations where parents want to delegate their health care decision-making power for their minor children to a temporary custodian of their children, for instance when parents plan to be unavailable or when a child is living at camp. The delegation of authority is broader in some aspects than that currently

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[81]Ind. Code § 30-2-11-1 to -7 (Supp. 1987).

[82]Hadley v. Hadley, 147 Ind. 423, 46 N.E. 823 (1897); *See generally* 23 I.L.E. *Powers* § 1 (1970).

[83]Ind. Code § 16-8-12-5(a) (Supp. 1987).

[84]*Id.*

[85]*Id.*

[86]*Id.*

allowed under Indiana Code section titled, "Parents or Guardians; Delegation of Powers."[87] This section of the Indiana Code allows a parent to make a similar delegation through a properly executed Durable Power of Attorney.[88] However, the delegation is limited to sixty (60) days and to those situations where the parent is to be outside of the state or physically incapacitated.[89] Section 5 of the new Act allows the delegation to be operative for a reasonable period of time during which the parents are not otherwise available, and is not limited to those instances where the parent is out of the state.[90] For these reasons, the delegation of a parent's health care decision-making authority for their minor child is better effected through section 5 of the Health Care Consent Act which was enacted specifically for such a delegation.

VI. Other Provisions of the Act

Section 1 defines the various terms used in the new Act.[91] It states the Act applies to health care providers as defined in Indiana's Medical Malpractice Statute[92] (which now includes nursing homes, and certain corporations and partnerships).[93] The section also limits the consent authority of an authorized individual to "health care" decisions, which by definition includes consent to admission to a health care facility, but does not include a mental health facility.[94]

Section 7 of the Act gives specific authority for a health care provider or any interested party to petition the probate court to: (1) make a health care decision or order health care for an individual incapable of consenting; or (2) appoint a representative to act for that individual.[95] This section may provide an alternative to the appointment of a guardian to make health care decisions for a ward under Indiana's Temporary Guardian Statute.[96] Normally, when an Indiana health care provider is presented with an incompetent patient to whom it wishes to render medical treatment and no individual is present who possesses valid consent

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[87] *Id.* § 29-1-18-28.5.

[88] *Id.*

[89] *Id.*

[90] *Id.* § 16-8-12-5.

[91] *Id.* § 16-8-12-1.

[92] *Id.* § 16-8-12-1(3). This section provides: " 'Health care provider' has the meaning set forth in I.C. 16-9.5-1-1. The term also includes a health facility as defined in I.C. 16-10-4-2." *Id.*

[93] Pursuant to House Enrolled Act No. 1210, codified at Ind. Code § 16-9.5-1-1(a) (effective September 1, 1987).

[94] Ind. Code § 16-8-12-1(2) (Supp. 1987).

[95] *Id.* § 16-8-12-7(a)(2).

[96] Ind. Code § 29-1-18-24 (1982).

power (or such individual is present but refuses to exercise that power—such as the case where a Jehovah's Witness parent refuses to consent to a blood transfusion for his minor child), the health care provider petitions the probate court to appoint a temporary guardian to consent to the medical treatment on behalf of the incompetent.[97] Seemingly, section 7 is tailored to this type of decision and may provide for a better procedure by which the court may appoint a representative to make health care decisions on behalf of the incapable patient.

However, the health care provider seeking the appointment of a health care representative under section 7 is cautioned of two potential drawbacks. First, in a temporary guardianship proceeding, the court usually orders the guardian to consent to one isolated instance of treatment after which the temporary guardian has exhausted his powers and the guardianship terminates.[98] If a health care representative is appointed under the new Act he appears to have the ability to consent to any type of health care, including the consent to withhold treatment, which may be contrary to the purpose of the judicial proceeding in the first place.

Another potential drawback to the use of Section 7 for the appointment of a health care representative is that Section 7 grants the probate court jurisdiction but does not provide a place of preferred venue. Pursuant to House Enrolled Act Number 1404 which amended the Probate Code, effective September 1, 1987, preferred venue for the appointment of a temporary guardian may be in *either* the county where the health care facility offering the services is located or in the incompetent's county of residence.[99] The preferred venue question may be a very important issue because many cases present situations where the patient has been transferred from another county. Under the Health Care Consent Act, the probate court would be compelled to grant a motion for change of venue to the incompetent's county of residence if such a motion was made by opposing counsel.[100] The change of venue would undoubtedly consume valuable time in a situation that often may present life and death issues. Thus, section 7 could be limited to those cases where the patient's residence is in the county of the facility providing the health care services. Regardless, an appointment of a health care representative under section 7 can be limited to consent authority for a specific medical procedure and the petition should ask the court to order the representative to consent to the treatment if the testimony

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[97]*Id.*

[98]Ind. Code § 29-1-18-24, 47(b)(4) (1982 & Supp. 1987).

[99]*Id.* § 29-1-18-7(1).

[100]Ind. Code § 16-8-12-7 (Supp. 1987).

indicates the treatment is medically necessary. Also, because the authority of a health care representative does not automatically terminate, as does the authority of a temporary guardian, the health care representative may be required to make periodic reports to the appointing court regarding the patient's status and the need for consent authority.

Section 9 grants immunity from criminal or civil liability and professional discipline if the health care provider follows the provisions of the Act in good faith.[101] As such, the health care provider is permitted to rely on the consent of an individual whom he, in good faith, believes is authorized to consent to health care.[102] The immunity provided in this section does not protect a substitute decision-maker from liability arising from negligence or other breach of duties, but only from liability for acting without authority if he in good faith believes that he is authorized to give consent.[103]

Section 10 provides that persons authorized to give consent under the Act have the same right to receive relevant medical information and health records as the appointor, and may consent to the release of medical records by a health care provider.[104] This section guarantees the right to receive relevant information but makes no attempt to define the scope of disclosure required by the health care provider. Presumably, the representative has the same right to medical information as the patient.

Section 11 provides that Chapter twelve is not to affect Indiana law concerning the consent to withdraw or withhold medical care, nor is it meant to affect the requirements of any other law concerning consent to observation, diagnosis, treatment, or hospitalization for a mental illness.[105] Further, the Act is not to affect Indiana law concerning health care provided without consent in an emergency.[106] Section 11 notwithstanding, it is inevitable that the issue will arise as to whether a surrogate decision-maker may give valid consent to the withholding or withdrawal of medical treatment on behalf of the appointor.

VII. Withholding or Withdrawing Life-Supporting Procedures under the Health Care Consent Act

The medical and legal professions have long struggled with the issue of when withholding or withdrawing life-supporting measures from a

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[101] *Id.* § 16-8-12-9(a).

[102] *Id.* § 16-8-12-9(b).

[103] Model Health-Care Consent Act (Uniform Law Commissioners) § 9 comment (1982).

[104] Ind. Code § 16-8-12-10 (Supp. 1987).

[105] *Id.* § 16-8-12-11(a) -(b).

[106] *Id.* § 16-8-12-11(e)(5).

terminally ill patient is medically indicated, legally sound and in the patient's best interests. As well, the state, through its role of *parens patriae*, has an interest in the life and death of its citizens and may prolong an individual's life, even against his expressed desires.[107] In reality, competent patients do not have an unqualified right to make health care decisions concerning their treatment when balanced against compelling state interests. However, the trend has been to give increasing weight to the individual's right to control his own medical treatment.[108] Indiana's Living Wills and Life-Prolonging Procedures Act,[109] and now the Health Care Consent Act,[110] are manifestations of the increasingly strong affirmation that an individual should have substantial control over his medical care. The doctrine of informed consent is the foundation upon which this affirmation stands, and both of these Indiana statutes build upon that important concept.

Section 11(a) of the Health Care Consent Act states: "This chapter does not affect Indiana law concerning an individual's authorization to make a health care decision for the individual or another individual, or to provide, withdraw or withhold medical care necessary to prolong or sustain life."[111]

As such, the Health Care Consent Act was not intended to affect Indiana's Living Wills and Life-Prolonging Procedures Act. However, when considering the two Acts separately, there is clear legislative pronouncement that, on the one hand, a competent adult diagnosed as having a terminal condition may give valid consent to the withdrawal or prolongation of life-supporting procedures through a declaration made prior to becoming incapacitated.[112] On the other hand, the same individual has the right to appoint another person to make health care decisions on his behalf in the event of his incapacity.[113] Given the legislative intent of the two Acts, the question arises whether an individual authorized to exercise consent under the Health Care Consent Act may consent to

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[107]*See supra* note 64.

[108]*See, e.g.*, Bouvia v. Superior Court, 179 Cal. App. 3d 1127, 225 Cal. Rptr. 297 (1986); Bartling v. Superior Court, 103 Cal. App. 2d 186, 209 Cal. Rptr. 220 (1984); John F. Kennedy Memorial Hosp., Inc. v. Bludworth, 452 So. 2d 921 (Fla. 1984); *In re* Farrell, 529 A.2d 404 (N.J. 1987); Matter of Requena, 213 N.J. Super. 475, 517 A.2d 886 (1986); *In re* Conroy, 188 N.J. Super. 523, 457 A.2d 1232 (1983), *rev'd,* 190 N.J. Super 453, 464 A.2d 303 (1983), *rev'd*, 90 N.J. 321, 486 A.2d 1209 (1985); *In re* Quinlan, 70 N.J. 10, 355 A.2d 647 (1976), *cert. denied sub. nom.* Garger v. New Jersey, 429 U.S. 922 (1976).

[109]IND. CODE §§ 16-8-11-1 to -22 (Supp. 1987).

[110]*Id.* §§ 16-8-12-1 to -12.

[111]*Id.* § 16-8-12-11(a).

[112]*Id.* § 16-8-11-11.

[113]*Id.* § 16-8-12-6.

the withdrawal or withholding of life-supporting measures on behalf of the terminally ill patient.

A. Ascertaining the Intent of the Declarant in a Living Will

It is clear that a health care provider presented with an individual who has expressed his desires in a properly executed living will may withdraw or withhold life-supporting procedures with little risk of civil or criminal liability or professional discipline.[114] However, under the Living Wills statute, the attending physician who questions the validity of a living will is to consult with *any* of the following individuals to ascertain the intent of the declarant:

> (1) The judicially appointed guardian of the person of the patient if one has been appointed. . . .
> (2) The person or persons designated by the patient in writing to make the treatment decision for the patient should the patient be diagnosed as suffering from a terminal condition.
> (3) The patient's spouse.
> (4) An adult child of the patient or, if the patient has more than one (1) adult child, by a majority of the children who are reasonably available for consultation.
> (5) The parents of the patient.
> (6) An adult sibling of the patient or, if the patient has more than one (1) adult sibling, by a majority of the siblings who are reasonably available for consultation.
> (7) The patient's clergy or others with first hand knowledge of the patient's intention.[115]

In the author's opinion the Health Care Consent Act provides clearer guidance for the provider by giving a priority list of who may be consulted to ascertain the declarant's intent before carrying out the terms of a questionable living will declaration.[116] It would seem prudent that the attending physician turn to the priority list of those who may exercise substituted consent under the Health Care Consent Act, or to the health care representative if one has been appointed, to determine the intent of the patient in the event the physician questions the validity of the living will declaration. In other words, the attending physician may be advised to follow the priority list under the Health Care Consent Act rather than make an individual choice from among the seven categories of authorized individuals under the Living Wills and Life-Prolonging

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[114] *Id.* § 16-8-11-10.
[115] *Id.* § 16-8-11-14(g)(1) -(7).
[116] *Id.* § 16-8-12-4.

Procedures Act to determine the intent of the patient with respect to a questionable living will. If the physician and the surrogate agree that the living will was validly executed and that it evidences the intent of the declarant, the attending physician may wish to obtain the consent of that surrogate before carrying out the terms of the living will. Even absent such consent, the physician has an obligation to carry out the terms of the living will once he is convinced of its validity, or to transfer the patient to a physician who will honor the declaration.[117] In any event, the consent of the health care representative to the withholding or withdrawal of life-supporting treatment under the Living Wills statute provides one more important safeguard in a situation that is both medically and legally significant. Therefore, the presence of such surrogate consent in the patient's medical record is advised.

B. *Consent to Withholding of Life-Supporting Measures*

Absent a valid will and any expressed terms in a written delegation, the attending physician may turn to the Health Care Consent Act's definition of "health care" to determine the scope of decision-making authority possessed by the representative, and whether that scope encompasses consent to the withdrawal or withholding of life-supporting procedures.[118] Under the Act, health care is defined as: "[a]ny care, treatment, service, or procedure to maintain, diagnose, or treat an individual's physical or mental condition. The term includes admission to a health care facility."[119] One interpretation of this definition is that in order for a proxy decision-maker to give legal consent to the withdrawal or withholding of life-supporting measures, the Act's definition of health care must be construed to include the withdrawal or withholding of medical care as "treatment."

The withholding of life-supporting procedures is most often pursuant to a physician's written order to "Do Not Resuscitate" (DNR). A "Do Not Resuscitate" order is a physician's order not to begin life-supporting measures or resuscitative measures in the expected event of cardiac and/or respiratory arrest. The Health Care Consent Act[120] and the Living Wills and Life Prolonging Procedures Act[121] codify the common law principle that a competent patient may consent to, or refuse consent, to medical treatment even though a refusal to consent to treatment may result in the patient's death.[122] Accordingly, a competent individual may

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[117] *Id.* § 16-8-11-14(e).
[118] *Id.* § 16-8-12-1(2).
[119] *Id.* § 16-8-12-1(2).
[120] *Id.* §§ 16-8-12-1 to -12.
[121] *Id.* §§ 16-8-11-1 to -22.
[122] *Id.* §§ 16-8-11-10(a), 16-8-12-2(1).

instruct his physician not to institute life-supporting measures or resuscitative measures in the event of cardiac and/or respiratory arrest. This analysis supports the contention that the withholding of life-supporting measures is to be construed as a form of medical treatment to which a competent patient may or may not consent, and as such may fall within the Act's definition of health care.

There are no Indiana statutes or precedents addressing "Do Not Resuscitate" orders or other orders to withhold treatment in cases where incompetent or incapable patients have not executed a living will. However, courts in several other states have expressed their opinion that there is no necessity for physicians and family members to seek court guidance in making such health care decisions on behalf of the incompetent patient.[123] Given such rulings and the opinion of the author that the withholding of life-supporting measures constitutes medical treatment to which a competent patient may consent, and the intent of the legislature to preserve the patient's autonomy to make decisions concerning his own health care, it follows that, absent expressed terms to the contrary, an individual authorized under the Health Care Consent Act to consent to health care for an incapable patient, may give valid consent to a DNR order or other order to withhold life-supporting measures. The DNR order may thus be a form of health care contemplated by the Act to which substituted, proxy, or delegated consent may be given, section 11 notwithstanding.

C. *Consent to the Withdrawal of Life-Supporting Measures*

The issue of whether a proxy, substituted, or delegated consent-giver may consent to the *withdrawal* of life-supporting measures as medical treatment presents a similar legal analysis as the withholding of treatment. However, from an emotional and practical standpoint it may be more difficult to resolve. From some perspectives, the withdrawal of life supporting procedures may be more of an affirmative act to end one's life than the withholding of those procedures, and as such may be an even harder decision for the individual patient or his representative to make. However, the court decisions have uniformly held life-supporting measures may be terminated under exactly the same circumstances in which a decision not to institute them would be proper.[124] Arguably

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[123]*See supra* note 108. *See also In re* Dinnerstein, 6 Mass. App. Ct. 466, 475-6, 380 N.E.2d 134, 139 (1978) (declaring: "[T]hat on the findings made by the judge the law does not prohibit a course of medical treatment which excludes attempts at resuscitation in the event of cardiac or respiratory arrest and that the validity of an order to that effect does not depend on prior judicial approval.").

[124]*See* cases cited *supra* notes 108.

then, the Health Care Consent Act would also give a health care representative or other individuals authorized under the Act the authority to consent to the withdrawal of life-supporting measures as a form of consent to "health care."

Conversely, the consent to the withdrawal of health care may not be contemplated by the Act in light of section 11, and may be an overly broad construction of the legislative intent of the Act. Accordingly, it is incumbent upon the health care provider and its legal counsel to determine what risks are presented in each case before accepting substituted or proxy consent to the withdrawal of life supporting measures under the new Act. The safest and most conservative course is always through a court of competent jurisdiction and may well be the best route pending further legislative or judicial clarification of the Act's application in life and death decisions.

VIII. Conclusion

Indiana's new Health Care Consent Act is a legislative measure to clarify some of the many issues that have existed in Indiana consent law. By recognizing the concepts of substituted consent, proxy consent, and delegated consent by relatives, the Act provides to the health care professional a much needed statutory guide. It also provides certain immunities to the health care provider who proceeds in good faith to obtain necessary consent to health care. Equally important, the Act provides procedural safeguards designed to protect an individual's rights to self-determination and privacy with respect to health care decisions.

Clearly the Act is not a panacea for each and every problem of informed consent faced by a health care provider, but it is a bright light in a traditionally dark corner of Indiana consent law. As such, it can make the path of the health care provider less treacherous.

Underinsurance in Indiana: an Illusion of Coverage?

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I. Introduction

In its 1987 session, Indiana's General Assembly expanded the Uninsured Motorist Act,[1] by mandating that insurance carriers offer what is commonly known as underinsurance.[2] Simply stated, underinsurance is first party automobile coverage, intended to protect an insured when he is injured by a negligent third party motorist whose liability coverage is insufficient to compensate him adequately for his damages.[3] Assume that an individual is injured by a negligent motorist with $25,000 of bodily injury liability coverage. Assume further that the individual has damages exceeding that amount. In such a case, the negligent motorist is typically considered underinsured because his coverage does not adequately compensate the injured person. The injured person would then look to his own underinsurance coverage for additional compensation.

Initially, this Article will briefly outline the historical development of underinsured motorist coverage and the two types of legislative responses to the need for such coverage. The Article will then address Indiana's newly adopted underinsurance provisions and will conclude with an analysis demonstrating how Indiana's provisions may permit Indiana insurance carriers to provide merely an illusion of coverage to their insureds.

II. The Historical and Legislative Development of Underinsured Motorist Coverage

A. *How the Concept of Underinsurance Arose*

It cannot be denied that people often suffer enormous damages as a result of injuries they sustain in automobile collisions. States originally

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[1] Ind. Code §§ 27-7-5-2 to -6 (1982).

[2] *Id.* § 27-7-5-2, -4, and -5 (Supp. 1987).

[3] 2 A. Widiss, Uninsured and Underinsured Motorist Insurance § 32.1 (2d ed. 1987).

responded to the need for insurance to cover these damages by enacting legislation which prescribed minimum levels of liability insurance.[4] These prescribed limits, however, frequently did not adequately compensate victims of automobile accidents who were severely injured.[5] Furthermore, these financial responsibility laws did not generally mandate that citizens even obtain liability coverage on their vehicles.[6] Consequently, there were many instances when a person, severely injured by a negligent motorist without liability insurance, was left without any automobile insurance protection for his damages.

In order to provide protection for those accident victims injured by an uninsured motorist, the insurance industry developed a new form of coverage, commonly called uninsured motorist insurance.[7] Uninsured motorist insurance was designed as first party insurance which would place insureds in the same position they would have been in had the tortfeasor carried the minimum liability insurance required under the financial responsibility laws of the state.[8]

Shortly after the insurance industry began offering uninsured motorist insurance, many state legislatures enacted statutes either requiring that insurance companies *offer* such coverage to purchasers of liability coverage as optional coverage or requiring that insurance companies *include* such coverage in all liability policies.[9] Uninsured motorist insurance was almost exclusively offered in the same minimum limits prescribed by the financial responsibility laws of the particular state.[10] Although insurance companies were free to offer higher limit uninsured motorist coverage, almost no insurers did so.[11] Thus, as was the case with prescribed minimum levels of liability insurance, there were still many accident victims who suffered damages in excess of any insurance protection.

Because the minimum limit uninsured motorist coverage was inadequate, many state legislatures in the late 1960's and 1970's enacted legislation requiring insurance companies to make higher limit uninsured motorist insurance available to their insureds.[12] Generally, these statutes mandated that insurance carriers offer uninsured motorist protection in

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[4] *Id.* § 31.1.

[5] *Id.*

[6] *Id. See also* 1 *id.* §§ 1.1 - .14.

[7] 2 *id.* § 31.1.

[8] *Id.*

[9] *Id. See also* 1 *id.* §§ 1.11 and 2.5. Eleven states have mandatory uninsured motorist legislation. In the remaining states, insurance companies must offer uninsured motorist coverage, but the purchaser may reject the coverage. For a list of these states, see *id.* § 2.5.

[10] 2 *id.* § 31.2.

[11] *Id.* n.3.

[12] *Id.* § 31.3. *See also* 1 *id.* § 8.25.

limits equal to their insureds' liability coverage.[13] Thus, if an insured had \$100,000/\$300,000[14] of liability coverage, he could purchase the same amount of uninsured motorist coverage.

With the introduction of higher limit uninsured motorist insurance, injured accident victims were often compensated more fully if the tortfeasor was uninsured than if the tortfeasor carried the minimum liability coverage mandated by financial responsibility laws.[15] For example, assume that a tortfeasor only carried \$25,000/\$50,000 of liability coverage, the minimum amount required by his state's financial responsibility laws and the the victim carried \$100,000/\$300,000 of uninsured motorist coverage. Assume further that the victim had damages of \$100,000. Naturally, the victim would have preferred to collect the \$100,000 from his own carrier's uninsured motorist coverage rather than be left solely with the \$25,000 from the tortfeasor's liability coverage. Consequently, victims claimed that they were entitled to protection under their uninsured motorist insurance when the tortfeasor's liability coverage inadequately compensated them for their injuries.[16] However, insurance companies routinely denied such claims, arguing that uninsured motorist coverage only became operable when the tortfeasor was not in compliance with the state's minimum financial responsibility laws.[17] The insurance industry's position was generally sustained by the courts.[18] Clearly, the advent of higher limits uninsured motorist coverage created an anomaly that needed a solution.

The concept of underinsurance was developed to address this anomaly. Its purpose was to provide additional first party protection for accident victims who were injured by tortfeasors carrying minimum liability limits.[19] Although insurance companies frequently offered underinsurance to their insureds without a legislative mandate to do so,[20]

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[13]2 *id.* § 31.3.

[14]The figure on the left refers to the maximum amount payable to an individual injured by the insured. The figure on the right is the maximum amount payable to any number of individuals injured by the insured in a single occurrence.

[15]2 A. Widiss, *supra* note 3, § 31.3.

[16]*Id.*

[17]*Id.*

[18]*Id. See, e.g.*, State Farm Mut. Auto. Ins. Co. v. Hallowell, 426 A.2d 822 (Del. 1981); Smiley v. Estate of Toney, 44 Ill. 2d 127, 254 N.E.2d 440 (1969); Peacock v. Harper, 95 Nev. 596, 600 P.2d 223 (1979); Travelers Indem. Co. v. Stearns, 116 N.H. 285, 358 A.2d 402 (1976). *But see, e.g.*, Oleson v. Farmers Ins. Group, 185 Mont. 164, 605 P.2d 166 (1980).

[19]2 A. Widiss, *supra* note 3, §§ 31.2 and 31.4.

[20]Interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc. (Sept. 28, 1987). Mr. Roll indicated that all twenty-one member companies of the Insurance Institute were offering underinsured motorist coverage to their insureds prior to the passage of House Bill No. 1390 which enacted underinsurance legislation in Indiana.

many state legislatures during the 1970's and 1980's enacted underinsurance laws.[21] Currently, thirty states have enacted such legislation.[22]

B. Legislative Response to the Need for Underinsurance

As previously stated, the purpose of underinsured motorist coverage is to provide protection to innocent motorists and passengers who are injured as a result of the negligence of minimally insured drivers.[23] When enacting underinsurance statutes, most state legislatures have integrated provisions on underinsurance into existing uninsured motorist legislation[24] and have typically enacted one of two types of underinsurance statutes.[25] One type focuses on the victim's damages[26] whereas the other type focuses on the amount of the victim's underinsurance coverage.[27] The following sections of the Article will refer to these statutes as Type I and Type II statutes.

1. Type I Statute.—A Type I statute is designed to afford protection to the victim for the amount of damages suffered.[28] Type I underinsurance coverage generally applies when the victim's damages exceed the limit of the tortfeasor's liability coverage.[29] A typical Type I statute provides:

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[21]2 A. WIDISS, *supra* note 3, § 31.5.

[22]ARIZ. REV. STAT. ANN. § 20-259.01(E) (Supp. 1987); CONN. GEN. STAT. ANN. § 38-175c (West 1987); DEL. CODE ANN. tit. 18, § 3902(b)(3) (Supp. 1986); FLA. STAT. § 627.727 (1984); GA. CODE ANN. § 33-7-11 (Supp. 1987); ILL. ANN. STAT. ch. 73, para. 755a-2 (Smith-Hurd Supp. 1987); IND. CODE §§ 27-7-5-2, -4, and -5 (Supp. 1987); IOWA CODE ANN. § 516A.1 (West 1983); KAN. STAT. ANN. § 40-284 (Supp. 1984); KY. REV. STAT. ANN. § 304.39-320 (Michie/Bobbs-Merrill Supp. 1982); LA. REV. STAT. ANN. § 22:1406 (West 1978); ME. REV. STAT. ANN. tit. 24-A, § 2902 (Supp. 1986); MD. INS. CODE ANN. § 541 (Supp. 1983); MASS. GEN. L. ch. 175, § 113L (1987); MINN. STAT. § 65B.43 (1986); MISS. CODE ANN. § 83-11-103 (Supp. 1987); N.J. STAT. ANN. § 17:28-1.1 (West 1985); N.M. STAT. ANN. § 66-5-301 (1984); N.Y. INS. LAW § 3420 (McKinney 1985); N.C. GEN. STAT. § 20-279.21 (1983); OHIO REV. CODE ANN. § 3937.18 (Anderson Supp. 1986); OKLA. STAT. ANN. tit. 36, § 3636 (West Supp. 1987); S.C. CODE ANN. § 56-9-831 (Law. Co-op. Supp. 1983); S.D. CODIFIED LAWS ANN. §§ 58-11-9.4 and -9.5 (Supp. 1987); TENN. CODE ANN. § 56-7-1201 and -1202 (Supp. 1987); TEX. REV. CIV. STAT. ANN. art. 5.06-1 (Vernon 1981); VT. STAT. ANN. tit. 23, § 941 (Supp. 1986); VA. CODE ANN. § 38.2-2206 (1986); WASH. REV. CODE ANN. § 48-22.030 (Supp. 1987); W. VA. CODE § 33-6-31 (Supp. 1987).

[23]*See supra* text accompanying notes 3 and 19.

[24]2 A. WIDISS, *supra* note 3, § 31.5. Indiana was no exception. The legislature amended Indiana's existing Uninsured Motorist Act to include underinsurance protection. IND. CODE ANN. §§ 27-7-5-2, and -5 (West Supp. 1987).

[25]*See infra* text accompanying notes 28-34.

[26]*See infra* text accompanying notes 28-30.

[27]*See infra* text accompanying notes 31-33.

[28]2 A. WIDISS, *supra* note 3, § 35.2.

[29]*Id.*

> [An insurance carrier] shall also offer . . . underinsured motorist coverage . . . to provide coverage in the event that damages are sustained in excess of the liability limits carried by an . . . underinsured motorist.[30]

Thus, under a Type I statute, a comparison is made between the amount of victim's damages and the amount of the tortfeasor's liability coverage. If the victim's damages exceed the tortfeasor's liability coverage, underinsurance will be provided. For example, assume that a victim has suffered a $75,000 injury and has $50,000 of underinsurance. Assume further that the tortfeasor has $25,000 of bodily injury coverage. Under this hypothetical, a Type I statute would operate to provide full compensation to the victim. That is, the victim's damages of $75,000 are compared to the tortfeasor's liability limits of $25,000. Because the victim's damages exceed the tortfeasor's liability limits by $50,000, the victim will be able to collect his $50,000 of underinsurance coverage. Therefore, the victim has collected his entire $75,000 in damages—$25,000 from the tortfeasor and $50,000 from his own insurance company.

2. *Type II Statute.*—A Type II statute differs from a Type I statute in one very important respect. Under a Type II statute, the focus is *not* on the victim's damages but rather on the amount of the victim's underinsurance. The goal of a Type II statute is to put the victim in the same position he would have been in had the tortfeasor had liability coverage in limits equal to the victim's underinsured motorist coverage.[31] Underinsured motorist coverage applies only when the victim's underinsured motorist coverage exceeds the amount recoverable from the tortfeasor's liability policy.[32] Therefore, a victim will never collect more than the limits of his underinsured motorist coverage even though part or all of his recovery will be from the negligent tortfeasor. A typical statute of this type provides:

> The limits of liability for an insurer providing underinsured motorist coverage shall be the limits of such coverage, less those amounts actually recovered under all applicable bodily injury liability bonds and insurance policies covering persons liable to the insured.[33]

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[30]S.C. Code Ann. § 56-9-831 (Law. Co-op. Supp. 1986). Ten states have enacted Type I statutes. These states are Arizona, Iowa, Kentucky, Louisiana, Massachusetts, Minnesota, Oklahoma, South Carolina, South Dakota, and Washington. For citations to these states' statutes, see *supra* note 22 and accompanying text.

[31]2 A. Widiss, *supra* note 3, § 35.2.

[32]*Id.*

[33]Ohio Rev. Code Ann. § 3937.18(A)(2) (Anderson Supp. 1986). Twenty states have enacted Type II statutes. Thirteen states define an "underinsured motor vehicle" as one

As the statutory language above indicates, the victim can only collect underinsurance in the amount by which his underinsurance exceeds the amount paid by the tortfeasor's liability coverage. In other words, the amount paid under the tortfeasor's liability coverage operates as a setoff against the victim's underinsurance coverage.

In the above hypothetical, the victim would still collect $25,000 from the tortfeasor's liability coverage. However, the victim would not collect the additional $50,000 of underinsurance. Instead, the $25,000 collected from the tortfeasor would be setoff against the victim's underinsured motorist coverage, and the victim would only collect $25,000 of his own underinsurance. Consequently, the victim would receive a total of $50,000 for a $75,000 injury and would not be made whole for his injuries.

Because there is a strong societal interest in compensating injured parties as fully as possible,[34] it would seem that legislatures should be more inclined to enact Type I statutes which maximize protection afforded the victim as opposed to Type II statutes which often minimize such protection. With this background in mind, the Article will now focus on Indiana's response to the need for underinsurance.

III. Indiana's Underinsurance Statute

The 1987 Indiana General Assembly broadened the Uninsured Motorist Act to include underinsurance.[35] Prior to amending the uninsured

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with liability limits less than the insured victim's uninsured motorist limits. These states include Connecticut, Florida, Georgia, Kansas, Maine, Maryland, Mississippi, New Mexico, New York, Ohio, Tennessee, Vermont, and Virginia. In seven states, underinsurance is a separate form of coverage, and an "underinsured motor vehicle" is one with liability insurance limits less than the victim's underinsurance limits. These states are Delaware, Illinois, Indiana, New Jersey, North Carolina, Texas, and West Virginia. For citations to these states' statutes, see *supra* note 22 and accompanying text.

[34] W. Keeton, Prosser and Keeton on the Law of Torts § 1 (5th ed. 1984).

[35] *See supra* notes 1-2 and accompanying text. In an interview with George C. Gray, Legislative Chairman for the Indiana Trial Lawyers Association, Corp. (ITLA), Mr. Gray stated that ITLA submitted the original bill on underinsurance. The bill was sponsored by Representative John Thomas of Brazil, Indiana, an ITLA member. This bill was modeled on the Arizona statute, a Type I statute, which provides in pertinent part:

> "Underinsurance motorist coverage" includes coverage for a person if the sum of the limits of liability under all bodily injury or death liability bonds and liability insurance policies applicable at the time of the accident is less than the total damages for bodily injury or death resulting from the accident. To the extent that the total damages exceed the total applicable liability limits, the underinsurance motorist coverage provided in subsection C of this section is applicable to the difference.

Ariz. Rev. Stat. Ann. § 20-259.01(E) (Supp. 1987).

However, the insurance lobby supported a bill modeled after the Ohio statute, a

motorist statute, nearly all major insurance companies doing business in Indiana were already offering underinsured motorist protection in conjunction with their uninsured motorist coverage.[36] As of January 1, 1988, however, the legislature has mandated that *all* insurance companies offer underinsured motorist coverage.[37] Automobile liability insurance companies must now provide not only uninsured motorist coverage, but also underinsured motorist coverage in all policies delivered or issued in the state, unless the insured rejects these coverages in writing.[38] The

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Type II statute, which provides in relevant part:

> Underinsured motorist coverage, which shall be in an amount of coverage equivalent to the automobile liability or motor vehicle liability coverage and shall provide protection for an insured against loss for bodily injury, sickness, or disease, including death, where the limits of coverage available for payment to the insured under all bodily injury liability bonds and insurance policies covering persons liable to the insured are less than the limits for the insured's uninsured motorist coverage at the time of the accident. The limits of liability for an insurer providing underinsured motorist coverage shall be the limits of such coverage, less those amounts actually recovered under all applicable bodily injury liability bonds and insurance policies covering persons liable to the insured.

OHIO REV. CODE ANN. § 3937.18(A)(2) (Anderson Supp. 1986).

According to Mr. Gray, the ITLA bill was defeated in a subcommittee hearing. The ITLA nevertheless supported the modified bill even though it was a Type II statute permitting setoff. The ITLA reasoned that the bill provided certain advantages even with setoff: (1) insurance companies are now required under the act to offer underinsurance; (2) insurance companies must offer underinsurance in limits equal to the insured's liability limits; (3) insurance companies are now required to offer uninsured motorist coverage in limits equal to the insured's liability limits. Interview with George C. Gray, Legislative Chairman of the Indiana Trial Lawyers Association, Corp. (Oct. 2, 1987).

[36] *See supra* text accompanying note 20. According to Mr. Donald L. Roll, all major automobile insurance companies doing business in Indiana offered underinsurance with a setoff provision. The only exception was State Farm Mutual Automobile Insurance Company whose policy did not provide for setoff. Interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc. (Sept. 28, 1987).

State Farm's policy provided in pertinent part:

> 5. The most we pay will be the lesser of:
>   a. the difference between the amount of the INSURED's damages for BODILY INJURY, and the amount paid to the INSURED by or for any PERSON or organization who IS or may be held legally liable for the BODILY INJURY; or
>   b. the limits of liability of this coverage.

State Farm Mutual Automobile Policy, Section III [emphasis in policy].

According to a State Farm spokesman at State Farm's Corporate Headquarters in Bloomington, Illinois, State Farm's policy as of January 1, 1988 will include a setoff provision. Telephone interview with State Farm Mutual Insurance Company Spokesman (Sept. 30, 1987).

[37] IND. CODE §§ 27-7-5-2(a)(1) and -5 (Supp. 1987).

[38] *Id.* § 27-7-5-2(a), (b)(1), (2). House Bill No. 1390 provided in relevant part:

> The uninsured AND UNDERINSURED motorist ~~coverage~~ COVERAGES ~~may~~ MUST

minimum limits of these coverages must comply with the financial responsibility requirements of $25,000/$50,000 for bodily injury liability insurance coverage.[39] Additionally, an insurance carrier must provide uninsured and underinsured coverages in limits equal to the insured's bodily injury liability coverage.[40] However, an individual may purchase

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> be ~~offered~~ PROVIDED by insurers ~~in limits higher than~~ FOR EITHER A SINGLE OR FOR SEPARATE PREMIUMS, IN LIMITS EQUAL TO the limits of liability specified in the bodily injury ~~and property damage~~ liability provisions of an insured's policy, UNLESS SUCH COVERAGES HAVE BEEN REJECTED IN WRITING BY THE INSURED.
>
> (b) The named insured of an automobile or motor vehicle liability policy has the right ~~to reject,~~ in writing, ~~either or both~~ TO:
>
> (1) REJECT BOTH THE UNINSURED MOTORIST COVERAGE AND THE UNDERINSURED MOTORIST COVERAGE PROVIDED FOR IN THIS SECTION; OR
>
> (2) REJECT EITHER THE UNINSURED MOTORIST COVERAGE ALONE OR THE UNDERINSURED MOTORIST COVERAGE ALONE, IF THE INSURER PROVIDES THE COVERAGE NOT REJECTED SEPARATELY FROM THE COVERAGE REJECTED.

Act of May 6, 1987, § 1, 6 1987 Ind. Legis. Serv. 815, 816 (West).

[39]Ind. Code § 27-7-5-2(a)(1), (2) (Supp. 1987). House Bill No. 1390 provided in pertinent part:

> . . . ~~Each~~ THE INSURER SHALL MAKE AVAILABLE, IN EACH automobile liability or motor vehicle liability policy of insurance which is delivered or issued for delivery in this state with respect to any motor vehicle registered or principally garaged in this state, insuring against loss resulting from liability imposed by law for bodily injury or death suffered by any person and for injury to or destruction of property to others arising from the ownership, maintenance, or use of a motor vehicle, ~~must provide coverage~~, ~~either in the policy~~ or in a supplement to ~~it~~ SUCH A POLICY, THE FOLLOWING TYPES OF COVERAGE:
>
> (1) in limits for bodily injury or death and for injury to or destruction of property NOT LESS THAN THOSE set forth in IC 9-2-1-15 under policy provisions approved by the commissioner of insurance, for the protection of persons insured ~~thereunder~~ UNDER THE POLICY who are legally entitled to recover damages from owners or operators of uninsured OR UNDERINSURED motor vehicles because of bodily injury, sickness or disease, including death, and for THE PROTECTION OF PERSONS INSURED UNDER THE POLICY WHO ARE LEGALLY ENTITLED TO RECOVER DAMAGES FROM OWNERS OR OPERATORS OF UNINSURED MOTOR VEHICLES FOR injury to or destruction of property resulting therefrom; or
>
> (2) in limits for bodily injury or death NOT LESS THAN THOSE set forth in IC 9-2-1-15 under policy provisions approved by the commissioner of insurance, for the protection of persons insured under the policy provisions who are legally entitled to recover damages from owners or operators of uninsured OR UNDERINSURED motor vehicles because of bodily injury, sickness or disease, including death resulting therefrom.

Act of May 6, 1987, § 1, 6 1987 Ind. Legis. Serv. 815, 816 (West).

[40]Ind. Code § 27-7-5-2(a) (Supp. 1987). For the full text of this portion of the statute, see *supra* note 38 and accompanying text.

This Article does not attempt to address all issues this new underinsurance legislation will raise. It should be noted, however, that one important issue may lead to litigation. The legislation requires all insurance companies to *provide*, not merely to *offer*, uninsured and underinsured motorist coverages in limits equal to the insured's bodily injury liability

uninsured or underinsured coverages in limits exceeding his bodily injury liability coverage.[41]

Although this amendment will undoubtedly create many unresolved issues for the courts,[42] this Article does not attempt to address those issues. Instead, the Article will focus on Indiana's decision to enact a Type II statute allowing setoff.

Indiana's amendment provides for setoff in two separate sections. Indiana Code § 27-7-5-4(b) defines an underinsured motor vehicle as including:

> [A]n insured motor vehicle where the limits of coverage available for payment to the insured under all bodily injury liability policies covering persons liable to the insured are less than the limits for the insured's underinsured motorist coverage at the time of the accident, but does not include an uninsured motor vehicle as defined in subsection (a).[43]

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limits. IND. CODE § 27-7-5-2(a) (Supp. 1987). The insured is permitted to reject these coverages in writing. *Id.* § 27-7-5-2(b)(1) and (2). Assuming an insurance company provided uninsured and underinsured motorist coverages in limits less than the insured's liability limits, a court could easily find that the insurance company must nevertheless provide coverages at the higher limits. *See e.g.* Prudential Insurance Co. v. Marshall, 1 Ohio Misc. 2d 14, 440 N.E.2d 71 (1982).

From the wording in the statute, it is unclear whether the insured could reject in writing limits equal to his liability limits and then purchase lower limit uninsured and underinsured coverages. It is the authors' opinion that a strong argument could be made that an insurance company would be precluded from selling lower limit uninsured and underinsured coverages.

[41]IND. CODE § 27-7-5-2(a)(2) (Supp. 1987). House Bill No. 1390 provided in relevant part:

> UNINSURED MOTORIST COVERAGE OR UNDERINSURED MOTORIST COVERAGE MAY BE OFFERED BY AN INSURER IN AN AMOUNT EXCEEDING THE LIMITS OF LIABILITY SPECIFIED IN THE BODILY INJURY AND PROPERTY DAMAGE LIABILITY PROVISIONS OF THE INSURED'S POLICY.

Act of May 6, 1987, § 1, 1987 Ind. Legis. Serv. 815 (West).

[42]One issue that is sure to arise is the effect of Indiana's Comparative Fault Act upon the new underinsurance legislation.

Imagine the following hypothetical. A victim has $150,000 of damages and was 50% at fault in causing the collision. The tortfeasor, who was also 50% at fault, carried liability limits of $25,000/$50,000. Even after the 50% reduction for the victim's own fault, the victim's damages exceed the tortfeasor's liability limits of $25,000, and therefore, the victim would be entitled to collect the full $25,000 from the tortfeasor. Assume further that the victim has $100,000 of underinsurance protection. Applying Indiana's setoff provision, the maximum amount of underinsurance the victim can collect is $75,000.

The question that remains unsettled is whether this $75,000 should be further reduced by the percentage of the victim's fault under the principles of comparative fault. The statute does not specifically allow for such a reduction. Additionally, strong arguments can be advanced that the statute prohibits such reduction.

[43]IND. CODE § 27-7-5-4(b) (Supp. 1987).

This definition compares the amount of the tortfeasors' bodily injury coverage available for payment to the victim with the victim's underinsured motorist coverage. Like all Type II statutes, the focus is on the amount of the victim's underinsurance and *not* on the victim's damages.[44] That is, a vehicle is *under*insured only when the amount paid to the victim under all tortfeasors' liability policies is less than the victim's underinsurance policy limits. If the amount paid under all tortfeasors' liability policies is greater than or equal to the victim's underinsurance limits, underinsurance will not be available to the victim. In other words, the sum of the amount collected under the tortfeasors' policies is subtracted from or setoff against the victim's underinsurance coverage despite the fact that he may not have been fully compensated for his damages.[45]

The other provision of the amendment allowing setoff actually sets out the method for determining how much underinsurance is available. Indiana Code § 27-7-5-5(c) provides:

> (c) The maximum amount payable for bodily injury under uninsured or underinsured motorist coverage is the lesser of:
> (1) the difference between:
> (A) the amount paid in damages to the insured by or for any person or organization who may be liable for the insured's bodily injury; and
> (B) the per person limit of uninsured or under insured motorist coverage provided in the insured's policy; or
> (2) the difference between:
> (A) the total amount of damages incurred by the insured; and
> (B) the amount paid by or for any person or organization liable for the insured's bodily injury.[46]

Essentially, the method used is a three-step process. The first step involves computing the difference between the amount that the victim receives from all tortfeasors and the amount of the victim's underinsured coverage.[47] Assume that the victim receives $50,000 from the tortfeasor(s) and has $100,000 of underinsurance coverage. The difference is $50,000.

The second step involves computing the difference between the victim's total damages and the total amount paid by the tortfeasor(s).[48]

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[44] *See supra* text accompanying note 31.

[45] *See supra* text accompanying notes 31-33. For a detailed discussion concerning the operation of this statute in collisions involving more than two seriously injured victims, see *infra* text accompanying notes 52-54.

[46] IND. CODE § 27-7-5-5(c) (Supp. 1987).

[47] *Id.* § 27-7-5-5(c)(1)(A), (B).

[48] *Id.* § 27-7-5-5(c)(2)(A), (B).

Assume the victim's damages are $200,000 and the victim receives $50,000 from the tortfeasor(s). The difference is $150,000.

The third step compares the amounts arrived at in steps one and two. Under this statute, the maximum amount of underinsurance protection the victim can receive is the *lesser* of the two amounts.[49] In the above example, the amount arrived at in step one was $50,000, whereas the amount arrived at in step two was $150,000. Because $50,000 is less than $150,000, the victim would only receive $50,000 of his underinsurance despite the fact that he had $100,000 of such coverage. The victim's total recovery would be $100,000 — $50,000 from the tortfeasor and $50,000 from his own underinsurance.

Clearly, the victim has received some benefit from his underinsurance protection, but that benefit has been minimized by the setoff provision. Had there not been setoff in the above hypothetical, the victim would have collected $150,000 of his damages, i.e., $50,000 from the tortfeasor(s) and his full $100,000 of underinsurance coverage. Although the victim would still not have been fully compensated for his $200,000 injury, the absence of setoff certainly would have served to maximize his protection.

This minimization occurs every time the victim's recovery from the tortfeasor(s) exceeds or is equal to his underinsurance coverage. In these situations, setoff will always operate to eliminate underinsurance protection for the victim. For example, assume that a victim has $200,000 in damages and has purchased only $25,000 of underinsurance. Assume further that the victim has recovered $25,000 from the tortfeasor, his total liability limits. Because the tortfeasor's $25,000 of coverage is setoff against the victim's $25,000 of underinsurance coverage, the victim will collect only the $25,000 from the tortfeasor. The victim will collect nothing from his underinsurance carrier. The above example is particularly compelling in light of the fact that the minimum limit of bodily injury coverage in Indiana is $25,000,[50] and the minimum limit of underinsurance is likewise $25,000.[51] It should be noted, however, that this result can also occur in a higher limit situation. If a victim has $100,000 of underinsurance coverage, he will find himself without any underinsurance protection if he collects $100,000 or more from the tortfeasor(s) despite the fact that his damages may be in excess of $100,000.

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[49]*Id.* § 27-7-5-5(c). For a detailed discussion concerning the operation of this statute in collisions involving more than two seriously injured victims, see *infra* text accompanying notes 52-54.

[50]*Id.* § 9-2-1-15.

[51]*Id.* § 27-7-5-2.

At first blush, an insured might conclude that in the above situations, he has paid a premium and received no real coverage. This is not entirely accurate. For example, underinsurance might be available in an automobile collision involving more than two injured people. Assume that four people suffer total damages in excess of $50,000 when injured by a tortfeasor with minimum limits of $25,000/$50,000. In this case, the maximum shared by all four victims is $50,000 and the maximum any one victim could recover would be $25,000. Assuming the $50,000 is divided equally among the victims, each would receive $12,500 from the tortfeasor. If a victim also had $25,000 of underinsurance, the $12,500 received from the tortfeasor would be setoff against his $25,000 of underinsurance. Consequently, the victim would receive $12,500 of his underinsurance protection.

Despite the fact that the victim's underinsurance limits are identical to the tortfeasor's liability limits, the victim's underinsurance premium has indeed paid for some coverage. The language of Indiana's underinsurance amendment ensures this result. Specifically, the statute states that the amount setoff against the victim's underinsurance limits is the amount "available for payment to the insured,"[52] "the amount paid in damages to the insured,"[53] or "the amount paid, by or for any person or organization liable for the insured's bodily injury."[54] In other words, it is not the amount of the tortfeasor's liability coverage that determines the amount to be setoff, rather it is the amount actually recovered from the tortfeasor. Thus, if a victim is involved in a collision with more than two injured people, he may still receive some payment from his underinsurance even when his underinsurance limits are identical to the tortfeasor's liability limits.

Although setoff will not eliminate all underinsurance protection in the limited situation outlined above, there will nevertheless be many situations when setoff does eliminate all such protection.[55] Given this harsh reality, one wonders why Indiana's legislature chose to enact a Type II statute allowing setoff. In an interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc., Mr. Roll indicated that economic considerations motivated the insurance industry to lobby for setoff provisions.[56] He stated that nearly all major insurance com-

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[52]*Id.* § 27-7-5-4(b). For the full text of this portion of the statute, see *supra* text accompanying note 43.

[53]*Id.* § 27-7-5-5(c)(1)(A). For the full text of this portion of the statute, see *supra* text accompanying note 46.

[54]*Id.* § 27-7-5-5(c)(2)(B). For the full text of the statute, see *supra* text accompanying note 46.

[55]*See supra* text accompanying notes 50-51.

[56]Interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc. (Sept. 28, 1987).

panies doing business in Indiana were already offering underinsurance with setoff provisions in their policies. He further claimed that a non-setoff amendment would have resulted in increased rates. The insurance industry feared that a rate increase would cause insureds to reject underinsured motorist protection. If that occurred, the insurance industry would not only suffer a loss in premiums, but also the goal of broad protection would be compromised.[57]

Mr. Roll was unable to provide any specific projections of the actual rate increase that would result from offering non-setoff coverage as opposed to setoff coverage.[58] However, figures received from Indiana's Department of Insurance indicate that the rate increase feared by the insurance industry would not have been dramatic enough to cause insureds to reject non-setoff underinsurance coverage.[59]

The table below compares the annual rates of two major insurance companies doing business in Indiana: State Farm Mutual Automobile Insurance Company and American States Insurance Company. These rates were in effect in September of 1987 and were combined rates for both uninsured and underinsured coverages. This comparison is particularly significant because State Farm offered underinsurance without setoff whereas American States' policies included setoff provisions.

Annual Rate Comparison Table[60]

Limits of Coverage	State Farm	American States	Difference
$25,000/$50,000	$15.20	$ 9.00	$ 6.20
$50,000/$100,000	$22.60	$14.20	$ 8.40
$100,000/$300,000	$35.60	$18.40	$17.20

Although the annual rate comparison table is limited two companies,

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[57]*Id.*

[58]*Id.*

[59]Telephone interview with a spokesperson at the Indiana Department of Insurance (September 29, 1987). The Department of Insurance did not express any opinion concerning whether any increased rate for non-setoff underinsurance would cause consumers to reject such coverage.

[60]*Id.* The Department of Insurance provided the following separate semi-annual rates for uninsured and underinsured motorists coverages charged by State Farm which became effective February 1, 1987, for new policy owners and March 1, 1987, for renewals:

Limits of Coverage	*Uninsured*	*Underinsured*
$25,000/50,000	$ 3.60	$ 4.00
$50,000/100,000	$ 4.80	$ 6.50
$100,000/300,000	$ 5.80	$12.00

Id. These semi-annual rates were combined and doubled for the rates used in the Annual

it seems reasonable to conclude that the premiums charged are representative, given the competitive nature of automobile insurance underwriters.[61] In view of the moderate differences in premiums between non-setoff coverages and setoff coverages, the insurance industry's assumption that non-setoff underinsurance would be cost prohibitive for insureds is unfounded. It seems unlikely that insureds would reject non-setoff underinsurance based upon the rate differences cited above, assuming, of course, they understood the additional benefits they could receive with non-setoff coverage.

The Indiana Trial Lawyers Association, Corp. (ITLA) originally proposed a bill that would have prohibited setoff.[62] Following the defeat of that proposal in a subcommittee hearing, the ITLA elected to support the insurance industry's bill which was subsequently enacted.[63] The ITLA's decision to support the underinsurance bill allowing setoff was based on three advantages it perceived would result from a bill including setoff as opposed to no bill at all.[64] First, the ITLA believed that because all insurance companies would be required to offer underinsurance, more citizens would benefit from this extra coverage.[65] Second, because the bill mandates that insurance companies offer underinsurance in limits equal to the insured's liability limits,[66] the ITLA believed that insureds would be required to purchase higher amounts of underinsurance coverage than they previously had purchased.[67] Finally, because the bill mandates that insurance companies provide uninsured motorist coverage in limits

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Rate Comparison Chart.

The Department of Insurance provided the following combined semi-annual rates for uninsured and underinsured motorist coverages charged by American States. These rates were in effect in September of 1987:

Limits of Coverage	*Uninsured and Underinsured Combined Rates*
$25,000/50,000	$ 4.50
$50,000/100,000	$ 7.10
$100,000/300,000	$ 9.20

Id. These semi-annual rates were doubled for the rates used in the Annual Rate Comparison Table.

[61]Interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc. (Sept. 28, 1987).

[62]Interview with George C. Gray, Legislative Chairman for the Indiana Trial Lawyers Association, Corp. (Oct. 2, 1987). *See also supra* note 35 and accompanying text.

[63]*Id.*

[64]*Id.*

[65]*Id.*

[66]Ind. Code § 27-7-5-2(a) (Supp. 1987).

[67]Interview with George C. Gray, Legislative Chairman for the Indiana Trial Lawyers Association, Corp. (Oct. 2, 1987).

equal to the insured's liability limits,[68] the ITLA believed that insureds also would receive additional uninsured motorist protection.[69]

Although on the surface the new underinsurance provisions might appear advantageous to Indiana consumers, the end result of creating legislation in this area may have done consumers more harm than good. Prior to the enactment of underinsurance legislation, nearly all major insurance companies were already offering underinsurance to their insureds.[70] Although most of these companies were writing policies which contained setoff provisions, at least one Indiana arbitration decision struck down that provision and awarded the claimant the full amount of underinsurance coverage listed on her declaration sheet.[71] The arbitrators found that the presence of the setoff provision in the insurance contract gave rise to an ambiguity when considered in light of both the amount of underinsurance shown on the declaration sheet and the stated limit of liability provision contained in the policy. The arbitrators reasoned that if the setoff provision were enforced, the underinsurance limits provided for in the insurance contract could never be recovered in full. That is, enforcement of the setoff provision essentially would make meaningless the dollar amounts of coverage stated in the policy.[72] After concluding the ambiguity existed, the arbitrators resolved the ambiguity against the insurance carrier, consistent with well established principles of insurance law.[73]

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[68]Ind. Code § 27-7-5-2(2)(a) (Supp. 1987). *See also supra* notes 38-40 and accompanying text.

[69]Interview with George C. Gray, Legislative Chairman for the Indiana Trial Lawyers Association, Corp. (Oct. 2, 1987).

[70]Interview with Donald L. Roll, President of the Insurance Institute of Indiana, Inc. (Sept. 28, 1987).

[71]Kopack, *Fortener v. Commercial Union Insurance*, 7 Verdict 117 (1985).

[72]*Id.* In the *Fortener* case, the claimant had $100,000 of underinsurance coverage with Commercial Union Insurance. She collected the full $25,000 of liability limits from the tortfeasor. The insurance company argued for setoff based on the following policy language: "However, the limit of liability shall be reduced by all sums paid because of the bodily injury, or on behalf of persons or organizations that may be at fault." *Id.*

However, another section of the policy and the declaration sheet were used to support the argument that setoff should not be allowed: "The *Limit of Liability* in the Declarations for each person for underinsured motorist coverage is our *maximum* limit of liability for all damages for bodily injury sustained by any one person in any one accident." *Id.*

The three member arbitration panel found that the above policy sections and the declaration sheet created an ambiguity and thus awarded the claimant her full $100,000 of underinsurance coverage. *Id.*

[73]E. Fischer & P. Swisher, Principles of Insurance Law § 1.01 (1986). Under the theory of *contra proferentum*, or the "doctrine of ambiguities," an insurance contract will be strictly construed against the insurer and liberally construed in favor of the insured if the insurance contract is ambiguous. *Id. See, e.g.*, Leist v. Auto Owners Ins. Co., 160 Ind. App. 322, 311 N.E.2d 828 (1974).

Similarly, in *Transamerica Insurance Group v. Osborn*,[74] the court held that the presence of a setoff provision in the insurance contract, when read in conjunction with the insured's declaration sheet, gave rise to "an inherent ambiguity in the policy."[75] The ambiguity arose because the insured reasonably believed that he had purchased the full amount of coverage stated on his declaration sheet and *not* some amount diminished by setoff.[76] In resolving the ambiguity in favor of the insured, the court determined that the insured's reasonable expectations deserved protection. Consequently, the court awarded him the full amount of his underinsurance coverage.[77]

Despite the fact that the arguments outlined above were advanced in situations where there were no statutory provisions governing underinsurance, it may still be possible to raise these arguments in Indiana even after legislative approval of setoff. Although the legislature has sanctioned the sale of policies with setoff provisions, the legislature has not sanctioned the sale of ambiguous insurance contracts. In other words, even though the underinsurance policy will be written with reference to the statute,[78] the problem of ambiguity remains. A reasonable person, viewing the amount coverage on his declaration sheet, will still expect that he has purchased the full amount of coverage listed there. Therefore, it may nevertheless be possible to argue that the insurance policy read as a whole is ambiguous. To resolve that ambiguity and to protect the reasonable expectation of the insured, the setoff provision must be voided, and the insured must be provided the full amount of coverage on his declaration sheet.[79]

Additional evidence of the harm that may have resulted from underinsurance legislation permitting setoff is noted in State Farm Mutual Automobile Insurance Company's response to this legislation. Prior to

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[74]627 F. Supp. 1405 (D. Mont. 1986).

[75]*Id.* at 1409. The insured was seriously injured in an automobile collision and collected the policy limits of $25,000 from the negligent motorist. At the time of the collision, the insured had $50,000/person of underinsurance coverage listed on his declaration sheet. Because the insured's damages exceeded $75,000, he made a claim for the full $50,000 of underinsurance coverage. *Id.* at 1406.

[76]*Id.* 1408-09.

[77]*Id.* 1409-11. Although not in the context of underinsured motorist coverage, the Supreme Court of Indiana has adopted a similar analysis with regard to the interpretation of insurance contracts. If an ambiguity is found, the ambiguity is resolved to protect the reasonable expectations of the insured. Eli Lilly and Co. v. Home Ins. Co., 482 N.E.2d 467 (Ind. 1985).

[78]*See* Bocek v. Inter-Ins. Exch. of Chicago Motor Club, 175 Ind. App. 69, 369 N.E.2d 1093 (1977) ("[w]hen a contract of insurance is entered into on a matter surrounded by statutory limitations and requirements such as with uninsured motorist coverage the parties are presumed to have entered into their agreement with reference to the statute.").

[79]*See supra* text accompanying notes 71-77.

the passage of the new statute, State Farm, the largest automobile insurance underwriter in the state, was offering underinsurance coverage without setoff.[80] A State Farm spokesman indicated that had this legislation not been passed, State Farm would have continued to offer underinsurance without setoff. As of January 1, 1988, however, the underinsurance coverage offered by State Farm will contain setoff provisions.[81] Consequently, if this legislation had not been enacted, many Indiana consumers would have been insured under policies without setoff, thereby maximizing their underinsurance protection. State Farm's position has always been that absent statutory approval of setoff, its policies would be written without setoff provisions for the reasons outlined above. That is, State Farm feared litigation over the enforceability of a setoff provision in light of the ambiguity it creates in the insurance contract and the adverse impact it has on reasonable people's expectations.[82] Thus, it would appear that ITLA's position that some legislation in this area was better than none was ill advised.

It is perhaps difficult to fault Indiana's legislature for enacting an underinsurance bill with setoff when the two competing interest groups, the insurance industry and ITLA, both supported its passage. Unfortunately, however, the legislators' constituents, the citizens of Indiana, will be harmed by this bill. The goal of underinsurance legislation should be to compensate innocent victims of automobile collisions as fully as possible. A Type I statute precluding setoff would have achieved this goal. However, Indiana's citizens are now left with a statute which is not designed to afford maximum compensation to injured parties. Instead, the statute will often minimize, if not eliminate, any underinsurance protection citizens thought they had. Furthermore, one can well imagine the outrage of Indiana's citizens when they discover that they do not have the full coverage they thought they had purchased. The Indiana General Assembly should waste no time in amending the newly enacted underinsurance legislation to preclude setoff. Indiana's citizens expect and deserve more than this illusion of coverage.

IV. Conclusion

In the 1987 session of the Indiana General Assembly, the legislature expanded the Uninsured Motorist Act to include provisions on underinsurance.[83] Insurance carriers doing business in Indiana now must provide

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[80]Telephone interview with State Farm Mutual Insurance Company spokesman (Sept. 30, 1987). *See also supra* note 36 and accompanying text.

[81]*Id.*

[82]*Id.*

[83]Ind. Code § 27-7-5-2, -4, -5 (Supp. 1987).

their insureds underinsured and uninsured motorist coverages in amounts equal to their liability limits, unless the insureds reject those coverages in writing.

The goal of underinsurance should be to maximize protection for victims of automobile collisions who are seriously injured by minimally insured drivers. In fact, because Indiana's General Assembly enacted underinsurance legislation permitting setoff, this goal frequently will not be realized. Furthermore, Indiana's consumers will often find themselves without the coverage they assumed they had purchased. Because in many situations Indiana's consumers will have purchased nothing more than illusory coverage, the legislature should amend the underinsurance provisions to preclude setoff at its first opportunity.

The Indiana Insurance Guaranty Association Act: More Problems than Protection

James W. Hehner*
Mark R. Smith**

I. Indiana Insurance Guaranty Association v. Kiner[1]

Although the Indiana Insurance Guaranty Association Law of 1971[2] has been in effect for 16 years, the first judicial decision construing the substantive provisions of the Act was not handed down until February 12, 1987. The lack of cases interpreting the Act is difficult to understand, considering the lack of clarity of many of its provisions.

In 1974, John L. Kiner, Jr., a minor, and his mother, Cassell Kiner, filed a lawsuit against the owners and operators of a taxicab company for injuries sustained by John Kiner, when he was struck by a cab. The Kiners obtained jury verdicts in their favor and, on March 24, 1982, the court entered judgment for $8,000.00 on the verdict in favor of John Kiner, and $2,000.00 on the verdict for his mother. The judgment defendant had liability insurance with Kenilworth Insurance Company in Chicago, Illinois. Several days after the Indiana trial court entered judgment in favor of the Kiners, an Illinois court declared Kenilworth Insurance Company insolvent and entered a liquidation order. Although the Kiners filed a claim in the liquidation proceeding pending in the state of Illinois, they did not receive any payments to satisfy their judgment. Thereafter, the Kiners applied to the Indiana Insurance Guaranty Association for payment of both judgments entered in their favor.[3]

The IIGA declined to pay the Kiners' $10,000.00 claim and argued that it was not obligated to pay the entire amount of both judgments. The IIGA asserted that its obligation was limited to the "reasonable medical and hospital expenses"[4] of John L. Kiner, Jr., as well as "any

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[1] 503 N.E.2d 923 (Ind. Ct. App. 1987).

[2] Ind. Code §§ 27-6-8-1 to -19 (1982 & Supp. 1987). Through the remainder of this article, the Indiana Insurance Guaranty Association will be referred to as the "IIGA," and the Indiana Insurance Guaranty Association Law of 1971 will be referred to as the "Act."

[3] *Kiner*, 503 N.E.2d 923.

[4] *Id.* at 924.

amounts actually lost by reason of his inability to work and earn wages."[5] The IIGA's position was based upon Indiana Code section 27-6-8-7(a)(i)(1) which states:

> In the case of claims arising from bodily injury, sickness, or disease, including death resulting therefrom, the amount for which the association shall be obligated shall not exceed the claimant's reasonable expenses incurred for necessary medical, surgical, X-ray and dental services, including prosthetic devices and necessary ambulance, hospital, professional nursing and funeral services, and any amounts actually lost by reason of claimant's inability to work and earn wages or salary or their equivalent that would otherwise have been earned in the normal course of such injured claimant's employment, to which may be added at the discretion of the association a sum not to exceed one thousand dollars [$1,000] for all other costs and expense incurred by the claimant prior to the insolvency.[6]

The IIGA filed a summary judgment motion asserting that its liability was limited by the provisions of Indiana Code section 27-6-8-7(a)(i)(1). In denying the IIGA's motion for summary judgment, the trial court interpreted the word "claims" in Indiana Code section 27-6-8-7(a)(i)(1) to mean only "unpaid claims" and decided that this section of the Act did not apply to a judgment. The court believed that the limitations on damages outlined in Indiana Code section 27-6-8-7(a)(i)(1) did not apply to the judgments which were previously entered by the trial court in the Kiners' tort action.[7] Thereafter, the court granted summary judgment on the Kiners' claims against the IIGA and found that the association was obligated to pay the full amount of the Kiners' two judgments totalling $10,000.00, plus costs.[8] The Indiana Court of Appeals reversed the trial court's grant of summary judgment in favor of the Kiners and against the IIGA, and held that a genuine issue of material fact existed concerning whether the Kiners "fall within the class of persons protected by the guaranty law."[9] In addition to holding

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[5] *Id.*

[6] IND. CODE § 27-6-8-7(a)(i)(1) (1982). It is not clear from the *Kiner* decision what evidence was presented at trial relating to John Kiner's medical and hospital expenses or lost wages. Additionally, it is uncertain what evidence was presented to support the jury's verdict of $2,000.00 in favor of John Kiner's mother. As a result, it is not possible from the decision to determine what amounts other than medical expenses and lost wages might have been included in the jury's verdict totaling $10,000.00.

[7] *Kiner*, 503 N.E.2d at 924-25.

[8] *Id.* at 925.

[9] *Id.*

that the Kiners failed to establish that they fall within the class of persons protected by the Act, the appellate court provided a substantial discussion clarifying the meaning and application of the limitations contained in Indiana Code section 27-6-8-7.[10]

A. The Kiners Failed to Establish Whether They Fall Within the Class of Persons Protected by the Act

The court of appeals reversed the trial court's judgment in favor of the Kiners, in part, upon a determination that a genuine issue of material fact existed concerning applicability of the Act to the Kiners. The court carefully pointed out that a claimant bears all responsibility for demonstrating that he falls within the class of persons intended to be afforded protection or coverage by an insurance guaranty act. A claimant must demonstrate both that he has met all requirements of the guaranty law and that he has complied with any conditions precedent to asserting a claim. As a prerequisite to claiming coverage under the Act, an individual must demonstrate that he has a "covered claim" within the meaning of Indiana Code section 27-6-8-4(4).[11]

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[10] *Id.*

[11] *Id.* A "covered claim" is defined as:

> (A)n unpaid claim or judgment which arises out of and is within the coverage and not in excess of the applicable limits of an insurance policy to which this chapter applies issued by an insurer, if the insurer becomes an insolvent insurer after the effective date (January 1, 1972) of this chapter and (a) the claimant or insured is a resident of this state at the time of the insured event or (b) the property from which the claim arises is permanently located in this state. "Covered claim" shall be limited as provided in section 7 [27-6-8-7] of this chapter, and shall not include (1) any amount due any reinsurer, insurer, insurance pool, or underwriting association, as subrogation recoveries or otherwise; provided, that a claim for any such amount, asserted against a person insured under a policy issued by an insurer which has become an insolvent insurer, which if it were not a claim by or for the benefit of a reinsurer, insurer, insurance pool or underwriting association, would be a "covered claim" may be filed directly with the receiver or liquidator of the insolvent insurer, but in no event may any such claim be asserted in any legal action against the insured of such insolvent insurer; nor (2) any supplementary obligation including but not limited to adjustment fees and expenses, attorney fees and expenses, court costs, interest and bond premiums, whether arising as a policy benefit or otherwise, prior to the appointment of a liquidator; nor (3) any unpaid claim or judgment not filed timely or properly in the liquidation proceedings in accordance with the provisions of IC 27-1-4 [repealed] if the insolvent insurer is a domestic insurer or in accordance with the applicable provisions of the law of the state of domicile if the insolvent insurer is not a domestic insurer. All covered claims filed timely and properly in the liquidation proceedings shall be referred immediately to the association by the liquidator for processing as provided in this chapter.

IND. CODE § 27-6-8-4(4) (1982).

The definition of "covered claim" contains mandatory requirements which must be established by the claimant as a prerequisite of the assertion of any such claim. Additionally, the definition contains exclusionary language which specifically eliminates certain claims which would otherwise be covered but for the exclusionary language contained in the definition.[12]

The court of appeals in *Kiner* held that the Kiners failed to establish that the judgment which they obtained against the cab company "was within the coverage and not in excess of the applicable limits of the Kenilworth insurance policy; that the Kenilworth insurance policy was one to which this chapter applies; nor that the claimant or the insured was a resident of Indiana at the time of the accident."[13] Moreover, Indiana Code section 27-6-8-11 requires a claimant to exhaust his rights against all other applicable guaranty associations or insurance policies before asserting his claims against the IIGA. Any recoveries from other applicable insurance policies or guaranty associations shall be applied as a setoff or reduction to any amounts ultimately recovered from the IIGA.[14] The court of appeals held that the Kiners failed to demonstrate that they had exhausted their rights to recover from other guaranty associations or applicable insurance policies as required by Indiana Code section 27-6-8-11.[15]

B. All Covered Claims Under the Act are Limited by All Provisions of Indiana Code Section 27-6-8-7

The court of appeals decision in *Kiner* clarifies the applicability of the limitations outlined in Indiana Code section 27-6-8-7. The IIGA

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[12]Ind. Code § 27-6-8-4(4) (1982).

[13]*Kiner*, 503 N.E.2d at 925 (footnote omitted from quotation).

[14]Ind. Code § 27-6-8-11 (1982) provides:

(a) Any person having a claim against an insurer under any provision in an insurance policy other than a policy of an insolvent insurer which is also a covered claim, shall be required to exhaust first his right under the policy. Any amount payable on a covered claim under this chapter shall be reduced by the amount of recovery under the insurance policy.

(b) Any person having a claim which may be recovered under more than one [1] insurance guaranty association or its equivalent shall seek recovery first from the association of the place of residence of the insured except that if it is a first party claim for damage to property with a permanent location, he shall seek recovery first from the association of the location of the property, and if it is a workmen's compensation claim, he shall seek recovery first from the association of the residence of the claimant. Any recovery under this chapter shall be reduced by the amount of recovery from any other insurance guaranty association or its equivalent. [IC 27-6-8-11, as added by Acts 1971, P.L. 390, § 1.]

[15]*Kiner*, 503 N.E.2d at 925-26.

claimed that regardless of the amount of the verdicts rendered by the jury in the trial court, the IIGA's liability to the Kiners was limited to John Kiner's reasonable medical and hospital expenses and lost income pursuant to Indiana Code section 27-6-8-7(a)(i)(1).[16] The trial court determined that the limitations outlined in Indiana Code section 27-6-8-7(a)(i)(1) applied only to "unpaid claims" asserted against the IIGA and were not applicable to the judgments entered in favor of Mrs. Kiner and her son, John. The court of appeals determined that Indiana Code section 27-6-8-7(a)(i)(1) applies equally to unpaid claims as well as judgments, and held that "[*a*]*ll* covered claims are limited by *all* of section 7."[17] The court reasoned that the definition of a "covered claim" specifically states that covered claims are limited as provided in Indiana Code section 27-6-8-7. The court held that "the plain meaning of this provision is that a covered claim is limited by *all* of section 7. The provision does *not* state that judgments are exempt from this limitation. Nor does any other provision of the Guaranty Law."[18]

The court emphasized that its holding on this issue is consistent with the insurance guaranty laws of other states and that other jurisdictions do not treat judgments any differently than they do unpaid claims.[19] Thus, the limitations outlined in Indiana Code section 27-6-8-7 apply equally to all claims which meet the definition of a "covered claim" as outlined by Indiana Code section 27-6-8-4(4), whether such claim arises through a judgment or otherwise. As the court held in *Kiner*:

> Even if the Kiners are able to show that they fall within the class of persons protected by the statute, their recovery from the Association is limited to John Kiner's reasonable medical and hospital expenses and any amounts actually lost by reason of his inability to work and earn wages.[20]

II. The IIGA—A General Overview

All fifty states and the District of Columbia have enacted some form of a property/casualty guaranty association act.[21] The majority

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[16] *Id.* at 928. *See supra* text accompanying note 6.

[17] 503 N.E.2d at 927 (emphasis in original).

[18] *Id.* (emphasis in original).

[19] *Id.* The court discussed two cases from Illinois and one Florida decision relating to the guaranty laws of those states. *See* Florida Ins. Guar. Ass'n v. Dolan, 355 So.2d 141 (Fla. App. 1978); Nianick v. Edgewater Beach Hotel, 28 Ill. App. 3d 33, 328 N.E.2d 82 (1975); Lucas v. Illinois Guaranty Fund, 52 Ill. App. 3d 237, 10 Ill. Dec. 81, 367 N.E.2d 469 (1977).

[20] 503 N.E.2d at 928.

[21] Ala. Code § 27-42-1 to -20 (1986); Alaska Stat. § 21.80.010 to .190 (1984 &

of guaranty associations laws were enacted during the early 1970's in response to growing concern over the financial failure of insurance companies, and their resulting inability to discharge defense[22] and indemnity[23] obligations to their policyholders.

The Indiana Insurance Guaranty Association Law was enacted in 1971.[24] The IIGA is comprised of all persons[25] who are duly authorized

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Supp. 1987); Ariz. Rev. Stat. Ann. § 20-661 to -680 (West 1975 & Supp. 1986); Ark. Code § 23-90-101 to -123 (1987); Cal. Ins. Code § 1063 to 1063.14 (West 1972 & Supp. 1987); Colo. Rev. Stat. § 10-4-501 to -502 (1973 & Supp. 1986); Conn. Gen. Stat. Ann. § 38-273 to -289 (West 1987); Del. Code Ann. tit. 18, § 4201 to 4221 (1974 & Supp. 1986); D.C. Code Ann. § 35-1901 to -1917 (1981); Fla. Stat. Ann. § 631.50 to .70 (West 1984 & Supp. 1987); Ga. Code Ann. § 33-36-1 to -18 (1982 & Supp. 1987); Haw. Rev. Stat. § 431D-1 to -18 (1985); Idaho Code § 41-3601 to -3621 (1977 & Supp. 1987); Ill. Ann. Stat. ch. 73, para. 1065.82 to .103 (Smith-Hurd Supp. 1987); Ind. Code § 27-6-8-1 to -19 (1982 & Supp. 1987); Iowa Code Ann. § 515B.1 to .18 (Supp. 1987); Kan. Stat. Ann.§ 40-2901 to -2919 (1981); Ky. Rev. Stat. Ann. § 304-36-010 to 170 (Michie Bobbs-Merrill 1981 & Supp. 1986); La. Rev. Stat. Ann. § 22:1375 to -94 (West 1978 & Supp. 1987); Me. Rev. Stat. Ann. 24-A, § 4431-51 (1964 & Supp. 1986); Md. Ins. Code Ann. 48A-501 to -519 (1986 & Supp. 1987); Mass. Gen. Laws Ann. Ch. 175D, § 1-16 (West 1987); Mich. Comp. Laws Ann. § 500.7901 to .7949 (West 1983 & Supp. 1987); Minn. Stat. Ann. § 60C.01 to .20 (West 1986); Miss. Code Ann. § 83-23-101 to -137 (1972 & Supp. 1987); Mo. Ann. Stat. § 375.785 (Vernon Supp. 1987); Mont. Code Ann. § 33-10-101 to -117 (1987); Neb. Rev. Stat. § 44-2401 to -2418 (1984); Nev. Rev. Stat. § 687A.010 to .160 (1985); N.H. Rev. Stat. Ann. § 404-B:1 to :18 (1983); N.J. Stat. Ann. § 17:30A-1 to -20 (West 1985); N.M. Stat. Ann. § 59A-43-1 to -18 (1984); N.Y. Ins. Law § 7601 to 764 (McKinney 1985 & Supp. 1987); N.C. Gen. Stat. § 58-155.41 to .60 (1982 & Supp. 1987); N.D. Cent. Code § 26.1-42-01 to -15 (Supp. 1987); Ohio Rev. Code Ann. § 3955.01 to .21 (Anderson 1971 & Supp. 1986); Okla. Stat. tit. 36, § 2001 to 2020 (Supp. 1987); Or. Rev. Stat. § 734.510 to .710 (1985); Pa. Stat. Ann. tit. 40. § 1701.101 to .605 (Purdon 1971 & Supp. 1987); R.I. Gen. Laws § 27-34-1 to -18 (1979 & Supp. 1987); S.C. Code Ann. § 38-19-10 to -180 (Law Co-op. 1976 & Supp. 1986); S.D. Codified Laws Ann. § 58-29A-1 to -53 (1978 & Supp. 1987); Tenn. Code Ann. § 56-12-101 to -119 (1980 & Supp. 1987); Tex. Ins. Code Ann. §§ 21.28-C to -22 (Vernon 1981 & Supp. 1987); Utah Code Ann. § 31A-28-201 to -220 (1986); Vt. Stat. Ann. tit. 8, § 3611 to 3626 (1984); Va. Code Ann. § 38.2-1600 to -1623 (1986 & Supp. 1987); Wash. Rev. Code Ann. § 48.32.010 to .930 (1984); W. Va. Code § 33-26-1 to -18 (1982 & Supp. 1987); Wis. Stat. Ann. § 646.01 to .73 (West 1980 & Supp. 1987); Wyo. Stat. § 26-31-101 to -117 (1977).

[22]Most liability policies contain a provision obligating the insurance company to provide a defense to the insured for any claim or suit covered by the policy. *See, e.g.*, Cincinnati Insurance Co. v. Mallon, 409 N.E.2d 1100 (Ind. Ct. App. 1980).

[23]The duty to indemnify can arise in either the first-party or third-party context. In the first-party context (*i.e.*, fire insurance, uninsured motorist), the insurer agrees to indemnify the insured for any injury or damage suffered by the insured. In the third-party context (*i.e.*, automobile liability coverage), the insurer agrees to indemnify the insured for any sums which the insured is legally obligated to pay another person (the third-party claimant) as a result of the insured's conduct or lack thereof.

[24]Ind. Code § 27-6-8-1 to -19 (1982 & Supp. 1987).

[25]Ind. Code § 27-6-8-4(8) (1982) defines "person" to mean "an individual, cor-

to transact certain types of insurance[26] in Indiana. Upon the insolvency of any member insurer, the IIGA stands in the shoes of the insolvent insurer, subject to all rights, duties and obligations of the insolvent insurer's policy as modified by certain terms and conditions of the Act.[27] Any costs incurred by the IIGA in defending any insured under a liability policy, all payment of "covered claims" by IIGA to any insured or third-party claimant, together with all administration costs are reimbursed by the remaining solvent member insurers through a periodic assessment.[28]

The purpose of the Act was expressed by the legislature as follows:

> The purpose of this chapter is to provide a mechanism for the payment of claims under certain insurance policies to avoid excessive delay in payment and to avoid excessive financial loss to claimants or policyholders because of the insolvency of an insurer, to assist in the detection and prevention of insurer insolvencies, and to provide an association to assess the cost of this protection among insurers.[29]

Despite this stated purpose, the Indiana Legislature has enacted one of the most restrictive guaranty association acts in the country, both from the standpoint of policyholder and third-party claimant protection.

A. *IIGA's Limit of Liability*

Indiana and Colorado stand alone as having the most restrictive liability limit provisions in their respective guaranty association laws. Both statutes provide that the guaranty association's maximum liability per claim is the lesser of: (1) the policy limits of the insolvent insurer; or (2) the sum of $50,000.00 less $100.00 statutory deductible.[30]

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poration, partnership, reciprocal or inter-insurance exchange, association or voluntary organization."

[26]Ind. Code § 27-6-8-3 (1982) restricts the scope of the Act "to all kinds of direct insurance except life, title, surety, disability, accident and sickness, health care, credit, mortgage guaranty, and ocean marine insurance." Ind. Code § 27-6-8-4(6) (1982) further excludes from the Act "farmers mutual insurance companies organized and operating pursuant to I.C. § 27-5 other than I.C. § 27-5-3 and I.C. § 27-5-4-2." "Direct insurance" has been defined by one court as "an insurance contract between the insured and the insurer which has accepted the risk of a designated loss to such insured, which relationship is direct and uninterrupted by the presence of another insurer." Zinke-Smith, Inc. v. Florida Ins. Guar. Ass'n, Inc., 304 So.2d 507, 508 (Fla. App. 1974).

[27]Ind. Code § 27-6-8-7(a)(iii) (1982).

[28]Ind. Code § 27-6-8-7(a)(ii) (1982).

[29]Ind. Code § 27-6-8-2 (1982).

[30]Colo. Rev. Stat. § 10-4-508(1)(a) (1973); Ind. Code § 27-6-8-7(a)(i) (1982).

A review of the limits of liability language contained in other jurisdictions' property/casualty guaranty association acts reveals that one jurisdiction has limits of $1,000,000.00 per claim;[31] one jurisdiction has limits of $500,000.00 per claim;[32] thirty-two jurisdictions have limits of $300,000.00 per claim;[33] four jurisdictions have limits of $150,000.00 per claim;[34] seven jurisdictions have limits of $100,000.00 per claim;[35] and two jurisdictions limit the association's liability solely to the limits contained in the policy of the insolvent insurance company.[36]

In addition to this low "per claim" limit of liability, the Indiana Act expressly provides that the association's liability is limited to $100,000.00 for all claims arising out of a single occurrence.[37] Thus, Indiana's "per occurrence" limit of liability is substantially less than the majority of other jurisdictions' "per claim" limits of liability. This

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[31]R.I. Gen. Laws § 27-34-6 (1979 & Supp. 1987).

[32]Cal. Ins. Code § 1063.1(c)(6) (West 1972 & Supp. 1987).

[33]Alaska Stat. § 21.80.060(a)(1) (1987); Ark. Code § 23-90-101 to -123 (1987); Conn. Gen. Stat. Ann. § 38-278(1)(a)(ii) (West 1987); Del. Code Ann. tit. 18, § 4208(a)(1) (1975); D.C. Code Ann. § 35-1906(a)(1) (1981); Fla. Stat. Ann. § 631.57(1)(a)(3) (West 1984); Hawaii Rev. Stat. § 431D-8(a)(1) (1985); Idaho Code § 41-3608(1)(a) (1977 & Supp. 1987); Iowa Code Ann. § 515B.5(1)(a) (Supp. 1987); Kan. Stat. Ann. § 40-2906(a)(1) (1981); Me. Rev. Stat. Ann. tit. 24-A, § 4438(1)(a) (1964 & Supp. 1986); Md. Ann. Code art. 48A, § 508(a)(1) (1986 & Supp. 1987); Mass. Gen. Laws Ann. ch. 175D, § 5(1)(a) (West 1987); Minn. Stat. Ann. § 60C.09(2) (West 1986); Miss. Code Ann. § 83-23-115(1)(a) (1973); Mo. Ann. Stat. § 375.785(4)(a) (Vernon Supp. 1987); Mont. Code Ann. § 33-10-105(1)(a) (1987); Neb. Rev. Stat. § 44-2406(1) (1984); Nev. Rev. Stat. § 687A.060(1)(a) (1985); N.H. Rev. Stat. Ann. § 404-B:8(1)(a) (1983); N.D. Cent. Code § 26.1-42-05(1)(a) (1960 & Supp. 1987); Ohio Rev. Code Ann. § 3955.01(B)(1) (Anderson 1971 & Supp. 1986); Or. Rev. Stat. § 734.570(1) (1977); Pa. Stat. Ann. tit. 40, § 1701.201(b)(1)(i) (1971); S.C. Code Ann. § 38-19-60(1)(a) (Law. Co-op. 1985); S.D. Codified Laws Ann. § 58-29A-16 (1978); Utah Code Ann. § 31A-28-207(1)(a) (1974); Vt. Stat. Ann. tit. 8 § 3615(a)(1) (1984); Va. Code Ann. § 38.2-1606(A)(1)(ii) (1986 & Supp. 1987); Wash. Rev. Code Ann. § 48.32.060(1)(a) (1984); W. Va. Code § 33-26-8(1)(a) (1982 & Supp. 1987); Wis. Stat. Ann. § 646.31(4) (West 1980 & Supp. 1987).

[34]Ala. Code § 27-42-8(a)(1) (1986); Ill. Ann. Stat. ch. 73, § 1065.87-2 (Smith-Hurd 1965 & Supp. 1987); La. Rev. Stat. Ann. § 22:1382(1)(a) (West 1978 & Supp. 1987); Okla Stat. Ann. tit. 36, § 2007(A)(1)(c) (West 1976 & Supp. 1987).

[35]Ariz. Rev. Stat. Ann. § 20-664(A)(1) (1975); Ga. Code Ann. § 33-36-3(2)(E); Ky. Rev. Stat. Ann. § 304.36-080(1)(a) (Michie/Bobbs-Merrill 1981 & Supp. 1986); N.M. Stat. Ann. § 59A-43-4(C) (1984); Tenn. Code Ann. § 56-12-107(a)(1) (1980); Tex. Ins. Code Ann. § 21.28-C(5)(2) (West Supp. 1987); Wyo. Stat. § 26-31-106(a)(i) (1983).

[36]Mich. Comp. Laws Ann. § 500.7925(c)(4) (West 1983); N.Y. Ins. Law § 7608(c) (McKinney 1985 & Supp. 1987).

[37]Ind. Code § 27-6-8-7(a)(1) (1982) provides that "in no event shall the association be obligated to a policy holder or claimant in an amount in excess of the applicable limits provided in the policy from which the claim arises; nor shall the association be obligated in an amount in excess of One Hundred Thousand Dollars [$100,000] for all claims arising out of a single occurrence . . . ."

disparity raises numerous questions concerning Indiana's commitment to providing fair and reasonable compensation to policyholders and third-party claimants upon the insolvency of an insurance company.

1. Property Damage Claims.—Property damage claims under the Act can arise in both first and third party contexts.[38] In the third-party context, the per claim and per occurrence limits of liability should not raise significant concern over the adequacy of compensation to property damage victims. On those occasions where the IIGA's limits are insufficient to fully compensate the property damage suffered, the injured party should have access to additional coverage under his own policy of insurance.[39] In fact, the property damage victim in most instances will have an affirmative duty under the Act to initially exhaust the coverage available under his own policy of insurance as a condition precedent to his right to pursue a claim against the IIGA.[40]

A more immediate concern over the IIGA's ability to fully compensate insured policyholders arises in the first party context, particularly in claims involving the destruction of residences and businesses by accidental fire or other means. Homeowner's and multi-peril commercial insurance would fall within the category of direct insurance subject to the Act.[41] If a homeowner's fire insurer was insolvent at the time that an accidental fire destroys the home, the $49,900.00 limit of liability under the Indiana Act may be insufficient to repay the equity in the home. This could be particularly ruinous to the typical class of homeowners (the elderly and retired) who have built up the most equity in their homes.

Of equal concern would be the potential financial impact upon the mortgage company who will be named in most instances as an additional insured in the homeowner's policy under the standard mortgage clause. Under Indiana law, the standard mortgage clause contained in the homeowner's policy would be construed to create a separate policy of

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[38]In the first-party context, the IIGA would take the place of the injured party's insolvent carrier for purposes of compensating the injured party's property damage. In the third-party context, the IIGA would take the place of the third-party tortfeasor's insolvent carrier for purposes of defending and indemnifying the tortfeasor for liability arising out of damage to the injured party's property.

[39]For example, in those rare automobile property damage cases exceeding $49,900.00, the automobile owner should have available to him collision or comprehensive coverage in his own automobile insurance policy. Additionally, in those cases involving property damage to homes, businesses, and inventory or contents, the property owner should have his own homeowner's or multi-peril business insurance policy to provide additional coverage.

[40]*See infra* text accompanying notes 140-81.

[41]IND. CODE § 27-6-8-3 (1982). In *Hardester v. Eubanks*, 731 S.W.2d 780 (Ark. 1987), a fire insurance policy was considered a "covered claim" under language similar to Indiana's act.

insurance for the benefit of the mortgage company.[42] Thus, the mortgage company should have a separate claim under the Act, with protection to a maximum of $49,900.00. Unless the mortgage company has also insured its interest in the property under another policy, the money recovered from the IIGA could be insufficient to cover the existing mortgage debt. Under these circumstances, the homeowner could be faced with a foreclosure action initiated by the mortgage company, as well as the possibility of a deficiency judgment.

This prospect is even more alarming in the context of an accidental fire destroying a business whose insurance company becomes insolvent. Most businesses purchase comprehensive insurance covering the building, the contents, and also insuring against business interruption or lost profits. If it is assumed that property damage to the building, contents and lost profits constitute three separate claims under the Act,[43] the $100,000.00 per occurrence limitation would be applicable.[44] Even in the "mom and pop" operation, it is not hard to imagine the situation where the IIGA's $100,000.00 limit would not cover the equity in the business' structure, contents, and any profits which were necessarily lost during reconstruction.

This problem of inadequate compensation would be equally applicable to a financial institution holding a mortgage on the business' building. To the extent that the mortgage holder has not insured its interest under another policy, its maximum recovery of $49,900.00 from the IIGA could be insufficient to satisfy the outstanding mortgage debt. Once again, it is not hard to imagine the scenario of the business owner facing a foreclosure action by the mortgage company, along with the prospects of a deficiency judgment.

2. Bodily Injury Claims.—Under Indiana law, recoverable damages in a personal injury action include: (1) the reasonable expense of necessary past and future medical care, treatment and services;[45] (2) the permanency of the injuries suffered;[46] (3) past and future physical pain and suffering;[47] (4) past and future mental pain, suffering and

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[42]Federal Nat. Mtg. Ass'n v. Great American Ins. Co., 300 N.E.2d 117, 119 (Ind. App. 1973).

[43]In this, and many other contexts, an issue will arise as to how many "claims" are being presented against the IIGA. Under the assumed facts, the insured has purchased three separate coverages, and has paid a premium for each separate coverage applicable to the building, contents, and lost profits. Thus, the assumption is made that three separate claims arose out of the same fire, thereby triggering the per occurrence limits of the Act.

[44]IND. CODE § 27-6-8-7(a)(i) (1982).

[45]Kavanagh v. Butorac, 140 Ind. App. 139, 144, 221 N.E.2d 824, 828 (1966).

[46]Town of Elkhart v. Ritter, 66 Ind. 136, 141 (1879); Giles v. Fortune, 156 Ind. App. 664, 667-68, 298 N.E.2d 34, 36 (1973).

[47]City of Evansville v. Rinehart, 142 Ind. App. 164, 170, 233 N.E.2d 495, 499 (1968); *Giles* 156 Ind. App. at 667-8, 298 N.E.2d at 36.

anguish;[48] (5) the aggravation of a previous injury, disease or condition;[49] (6) disfigurement and/or deformity resulting from the injuries;[50] (7) the value of lost wages or earnings;[51] and (8) loss of future earning capacity.[52] Indiana is one of only four states which preclude an injured party from recovering a majority of the damages identified above.[53]

Only Missouri,[54] Nebraska,[55] and Tennessee[56] contain similar restrictions in their respective guaranty association acts. These states'

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[48]Posey County v. Chamness, 438 N.E.2d 1041, 1050 (Ind. Ct. App. 1982).

[49]Dunkelbarger Const. Co. v. Watts, 488 N.E.2d 355, 358 (Ind. Ct. App. 1986); Johnson v. Bender, 174 Ind. App. 638, 644-45, 369 N.E.2d 936, 940 (1977).

[50]New York, C. & St. L. R.R. v. Henderson, 237 Ind. 456, 477, 146 N.E.2d 531, 543-44 (1957); Harrod v. Bisson, 48 Ind. App. 549, 560-61, 93 N.E. 1093, 1097 (1911).

[51]Reith-Riley Const. Co. v. McCarrell, 163 Ind. App. 613, 618, 325 N.E.2d 844, 848 (1975).

[52]State v. Totty, 423 N.E.2d 637, 646 (Ind. Ct. App. 1981); Duchane v. Johnson, 400 N.E.2d 193, 196 (Ind. Ct. App. 1980); *Reith-Riley*, 103 Ind. App. at 618, 325 N.E.2d at 848.

[53]*See infra* notes 54-57 and accompanying text.

> In the case of claims arising from bodily injury, sickness, or disease, including death resulting therefrom, the amount for which the association shall be obligated shall not exceed the claimant's reasonable expenses incurred for necessary medical, surgical, X-ray and dental services, including prosthetic devices and necessary ambulance, hospital, professional nursing and funeral services, and any amounts actually lost by reason of claimant's inability to work and earn wages or salary or their equivalent that would otherwise have been earned in the normal course of such injured claimant's employment, to which may be added at the discretion of the association a sum not to exceed one thousand dollars [$1,000] for all other costs and expense incurred by the claimant prior to the insolvency. In the case of a claim for wrongful death, the foregoing obligation of the association shall be subject to the limitations provided by the wrongful death statutes of the state of Indiana. Such amounts which are legally payable because of the death of a claimant shall be paid to his estate, or father or mother or guardian or to the surviving spouse or children or next of kin as set out in IC 34-1-1-2 and IC 34-1-1-8. The amount for which the association shall be obligated may also include payments in fact made to others, not members of claimant's household, which were reasonably incurred to obtain from such other persons ordinary and necessary services for the production of income in lieu of those services the claimant would have performed for himself had he not been injured.

IND. CODE § 27-6-8-7(a)(i)(1) (1982).

[54]MO. ANN. STAT. § 375.785(4)(1)(a)b (1972) provides:

> In the case of claims arising from bodily injury, sickness or disease, the amount of any such award shall not exceed the claimant's reasonable expenses incurred for necessary medical, surgical, x-ray, dental services and comparable services for individuals who, in the exercise of their constitutional rights, rely on spiritual means alone for healing in accordance with the tenets and practice of a recognized church or religious denomination by a duly accredited practitioner thereof, including prosthetic devices and necessary ambulance, hospital, professional nursing, and any amounts lost or to be lost by reason of claimant's inability to

guaranty association acts, however, provide for a much higher limit of liability[57] than does Indiana's Act.

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work and earn wages or salary or their equivalent, except that the association shall pay the full amount of any covered claim arising out of a workers' compensation policy. Such award may also include payments in fact made to others, not members of claimant's household, which were reasonably incurred to obtain from such other persons ordinary and necessary services for the production of income in lieu of those services the claimant would have performed for himself had he not been injured. Verdicts as respects only those civil actions as may be brought to recover damages as provided in this subsection shall specifically set out the sums applicable to each item in this subsection for which an award may be made.

[55]Neb. Rev. Stat. § 44-2406(3) (Supp. 1986) provides:

In the case of claims arising from bodily injury, sickness or disease, including death resulting therefrom, the amount of any such award shall not exceed the claimant's reasonable expenses incurred for necessary medical, surgical, X-ray, and dental services, including prosthetic devices and necessary ambulance, hospital, professional nursing, and funeral services, and any amounts actually lost by reason of claimant's inability to work and earn wages or salary or their equivalent, but not other income, that would otherwise have been earned in the normal course of such injured claimant's employment. Such award may also include payments in fact made to others, not members of claimant's household, which were reasonably incurred to obtain from such other persons ordinary and necessary services for the production of income in lieu of those services the claimant would have performed for himself or herself had he or she not been injured. The amount of any such award under this subsection shall be reduced by the amount the claimant is entitled to receive as the beneficiary under any health, accident, or disability insurance, or under any salary or wage continuation program under which he or she is entitled to benefits, or from his or her employer in the form of workers' compensation benefits, or any other such benefits to which the claimant is legally entitled, and any claimant who intentionally fails to correctly disclose his or her rights to any such benefits shall forfeit all rights which he or she may have by the provisions of the Nebraska Property and Liability Insurance Guaranty Association Act.

[56]Tenn. Code Ann. § 56-12-107(a)(1) (1980) provides:

In the case of claims other than workmen's compensation arising from bodily injury, sickness or disease, including death resulting therefrom, the amount for which the association shall be obligated shall not exceed the claimant's reasonable expenses incurred for necessary medical, surgical, X-ray and dental services, including prosthetic devices and necessary ambulance, hospital, professional nursing and funeral services, and any amounts actually lost by reason of claimant's inability to work and earn wages or salary or their equivalent that would otherwise have been earned in the normal course of such injured claimant's employment, to which may be added at the discretion of the association an additional sum as compensation for permanent physical impairment if said payment can be made within the policy limits.

[57]Missouri's act provides coverage of $300,000.00, less a $200.00 deductible. Mo. Ann. Stat. § 375.785(4)(1)(a) (1982). Nebraska's act provides coverage of $300,000.00. Neb. Rev. Stat. § 44-2406(1) (Supp. 1986). Tennessee's act provides coverage of $100,000.00, less a $100.00 deductible. Tenn. Code Ann. § 56-12-107(a)(1) (1980).

Even a cursory review of Indiana's Act reveals that the Act provides no coverage for some of the most devastating damages associated with personal injury. While under appropriate circumstances the Act would pay for a surgeon's medical bill to repair severe lacerations, the Act does not permit recovery of damages for the permanent scarring that the injured party will be required to live with for the rest of his life. While the Act may pay for a surgeon's bill to set a badly broken leg, it in no way provides any compensation for the fact that the injured party will walk with a limp for the rest of his life, and can no longer participate in physical activities from which he or she derived enjoyment prior to the accident. While the Act may pay for the services of a rehabilitative therapist, it in no way compensates the injured person for the severe agony and pain which was suffered during the accident, during rehabilitation, or which will be suffered in the future.

Of equal concern is the Indiana Act's $49,900.00 limit of liability, particularly in light of rising medical costs. Any type of serious personal injury can quickly result in the injured party incurring more than $49,900.00 in medical expenses. To the extent that the injured party does not have health insurance or any other type of collateral insurance, the IIGA's maximum liability of $49,900.00 may not satisfy the injured party's medical obligations, which could have been otherwise satisfied if the tortfeasor had higher bodily injury limits.

B. The IIGA's Limit of Liability is Applicable to Workmen's Compensation Claims

Indiana's Act joins the majority of other jurisdictions to provide coverage for claims against a workmen's compensation carrier which has become insolvent.[58] Of the forty-four jurisdictions whose guaranty association acts cover workmen's compensation insurance, thirty-seven of the jurisdictions include language in their statutes to the effect that the limitation of liability does not apply to workmen's compensation claims or that the guaranty association is required to pay the full amount of any covered claim arising out of a workmen's compensation policy.[59] Indiana is one of only seven jurisdictions whose limits of

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[58]The only states which exclude workmen's compensation claims from their property/casualty guaranty association acts are Arizona, Massachusetts, New Jersey, North Carolina, Pennsylvania, Washington, and West Virginia. Ariz. Rev. Stat. Ann. § 20-661(6) (West 1975); Mass. Gen. Laws Ann. ch. 175D § 2 (West 1987); N.J. Rev. Stat. Ann. § 17:30A-2(b) (West 1985); N.C. Gen. Stat. § 58-155.43 (1982); Pa. Stat. Ann. tit. 40 § 1701.103(3)(vii) (Purdon 1971); Wash. Rev. Code Ann. § 48.32.020 (West 1984); W. Va. Code § 33-26-3 (1982).

[59]Jurisdictions which specify that the full amount of any workmen's compensation

liability are applicable to any claim under a workmen's compensation policy.[60] Indiana's limit of liability of $49,900.00, however, is substantially lower than the limits of liability which would be applicable to workmen's compensation claims in the six other jurisdictions. Five jurisdictions provide coverage up to $300,000.00 for workmen's compensation claims,[61] while one jurisdiction provides that workmen's compensation payments cannot exceed policy limits.[62]

As previously noted, Indiana's Guaranty Association Act restricts recovery thereunder to medical expenses and lost income.[63] This re-

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claim shall be paid include Alabama, ALA. CODE § 27-42-8(1) (1986); Alaska, ALASKA STAT. § 21.80.060 (1984); California, CAL. INS. CODE § 1063.1(6) (West 1987); Colorado, COLO. REV. STAT. § 10-4-508(1)(a) (Supp. 1986); Connecticut, CONN. GEN. STAT. ANN. § 38-278(1)(a)(ii) (West 1987); Delaware, DEL. CODE ANN. tit. 18 § 4208(a)(1) (1975); the District of Columbia, D.C. CODE ANN. § 35-1906(a)(1) (1981); Florida, FLA. STAT. ANN. § 631.57(1)(a)(3) (West 1984); Georgia, GA. CODE ANN. § 33-36-3(2)(E) (Supp. 1987); Hawaii, HAW. REV. STAT. § 431D-8(a)(1) (1985); Idaho, IDAHO CODE § 41-3608(a) (Supp. 1987); Illinois, ILL. ANN. STAT. Ch. 73 § 1065-87-2 (Smith-Hurd Supp. 1987); Iowa, IOWA CODE ANN., 515 B.5(1)(a) (Supp. 1987); Kansas, KAN. STAT. ANN. § 40-2906(a)(1) (1981); Kentucky, KY. REV. STAT. ANN. § 304.36-080(1)(a) (Michie/Bobbs-Merrill 1981); Louisiana, LA. STAT. ANN. § 22:1382(1)(a) (Supp. 1987); Maine, ME. REV. STAT. ANN. tit. 24-A § 4438(1)(A) (Supp. 1987); Maryland, MD. INS. CODE ANN. art. 48A § 501-19; Michigan, MICH. COMP. LAWS ANN. § 500.7901-7949 (1983 & Supp. 1987); Minnesota, MINN. STAT. ANN. (1983 Supp. 1987) § 60C.09(2) (West 1986); Mississippi, MISS. CODE ANN. § 83-23-115(1)(a) (1972); Missouri, VERNON ANN. 375.785(4)(a) (Vernon Supp. 1987); Montana, MONT. CODE ANN. § 33-10-105(1)(a) (1987); Nebraska, NEB. REV. STAT. § 44-2406(1) (1984); New Hampshire, N.H. REV. STAT. ANN. § 404-B:8(1)(a) (1983); New Mexico, N.M. STAT ANN. § 21.28-C(5)(2) (West Supp. 1987); Oklahoma, OKLA. STAT. ANN. tit. 36 § 2007(A)(1)(a) (Supp. 1987); Oregon, OR. REV. STAT. § 734.570(1) (1985); Rhode Island, R.I. GEN. LAWS § 27-34-6 (Supp. 1987); South Carolina, S.C. CODE ANN. § 38-19-60(1)(a) (Law. Co-op. 1985); South Dakota, S.D. CODIFIED LAWS § 58-29A-16 (1978); Tennessee, TENN. CODE ANN. § 56-12-107(1) (Michie 1980); Texas, TEX. INS. CODE ANN. § 21.28-C(5)(2) (West Supp. 1987); Utah, UTAH CODE ANN. § 31A-28-207(1)(a) (1986); Vermont, VT. STAT. ANN. tit. 8 § 3615(a)(1) (1984); Virginia, VA. CODE ANN. § 38.2-1606(1)(i) (Supp. 1987); and Wyoming, WYO. STAT. § 26-31-106(a)(i)(A) (1977).

[60]Arkansas, ARK. CODE § 23-90-103 (1987); Indiana, IND. CODE § 27-6-8-3 (1982); Nevada, NEV. REV. STAT. § 687 A.033 (1985); New York, N.Y. INS. LAW § 7603(D) (McKinney 1985); North Dakota, N.D. CENT. CODE § 26.1-42-01 (Supp. 1987); Ohio, OHIO REV. CODE ANN. § 3955.01 (Anderson Supp. 1986); Wisconsin, WIS. STAT. ANN. § 646.01(1) (West Supp. 1987) are the only states whose limits of liability are applicable to any claims under a workmen's compensation policy.

[61]Arkansas, ARK. CODE § 23-90-103(2) (1987); Nevada, NEV. REV. STAT. § 687 A.060(1)(a) (1985); North Dakota, N.D. CENT. CODE § 26.1-42-05(1)(a) (Supp. 1987); Wisconsin, WIS. STAT. ANN. § 646.31(4) (West Supp. 1987) have a $300,000.00 limit of liability.

[62]New York, N.Y. INS. LAW § 7608(a) (McKinney 1985) and Ohio, OHIO REV. CODE ANN. 3955.08(A)(1) (Anderson Supp. 1986) provide that any payment for workmen's compensation cannot exceed the policy limits of the insolvent insurer.

[63]*See supra* note 45.

striction, together with the $49,900.00 limitation of liability applicable to workmen's compensation claims may create an irreconcilable conflict between the IIGA Act and the Indiana Workmen's Compensation Act.

The Indiana Workmen's Compensation Act was enacted in order to afford an expeditious remedy for work-induced injury or death which the worker or his dependents could pursue with a minimum of legal procedure.[64] In lieu of requiring the employee to successfully maintain a suit against the employer, the Act merely requires that the employee or his dependents demonstrate "personal injury or death by accident arising out of and in the course of employment."[65] In order to balance the effects of this "no-fault" legislation, the rights and remedies of the employee and dependents under the Workmen's Compensation Act constitute the exclusive remedy available against the employer.[66]

The Indiana Workmen's Compensation Act provides for certain mandatory benefits which must be awarded for a claim subject to the Act. These benefits include the payment of medical, surgical, hospital and nurse services,[67] temporary partial disability,[68] temporary total disability,[69] permanent impairment and/or disfigurement,[70] death benefits,[71] and burial expenses.[72] A comparison of the benefits available under the Indiana Workmen's Compensation Act and the IIGA Act reveals several inconsistencies that would arise in the event of a claim against the IIGA by virtue of a workmen's compensation insurer's insolvency.

First, as long as medical expenses are incurred within two years from the last day for which compensation was paid under an original award,[73] there is no limitation on the amount of medical expenses which an injured employee may be paid under the Workmen's Compensation Act.[74] By contrast, the IIGA Act precludes the recovery of medical expenses beyond the limit of liability of $49,900.00.[75]

Second, an award for "impairment" under the Indiana Workmen's Compensation Act strictly refers to the partial or total loss of function

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[64] *Thompson v. A.J. Thompson Stone Co.*, 81 Ind. App. 442, 144 N.E. 150 (1924).
[65] Ind. Code § 22-3-2-5 (Supp. 1987).
[66] Ind. Code § 22-3-2-6 (1982).
[67] *Id.* § 22-3-3-4.
[68] *Id.* § 22-3-3-9.
[69] *Id.* § 22-3-3-8.
[70] Ind. Code § 22-3-3-10 (Supp. 1987).
[71] Ind. Code §§ 22-3-3-16, -17 (1982 & Supp. 1987).
[72] Ind. Code § 22-3-3-21 (Supp. 1987).
[73] *Id.* § 22-3-3-27(c).
[74] *Id.* § 22-3-3-4.
[75] *Id.* § 27-6-8-7(a)(1) (1982).

of a part of the body or of the body as a whole, and not an impairment of wage earning powers.[76] By restricting recovery to medical expenses and lost income, the Act appears to preclude an injured employee's recovery of damages for impairment if the workmen's compensation carrier has become insolvent.[77]

As previously noted, an overwhelming majority of other jurisdictions, noting the restrictive nature of the Workmen's Compensation Act, have expressly provided that any limits of liability language in the Guaranty Association Act would not be applicable to a claim arising under a workmen's compensation act, and that the association would be required to satisfy in full any workmen's compensation claim.[78] It remains to be seen whether Indiana courts will permit the rights and remedies mandated under the Workmen's Compensation Act to be removed from coverage under the IIGA Act.

Of additional concern is the fact that the $49,900.00 limit of liability under the IIGA Act may in some circumstances be less than the amount which could be awarded under a workmen's compensation claim. Once again, the Indiana courts will presumably be required to determine whether the legislature can use the IIGA Act to place a lower limit of liability than that mandated by the Indiana Workmen's Compensation Act.

C. IIGA's Treatment of Subrogation Claims

The Act expressly requires any person having a claim against the IIGA to first exhaust his right under any other insurance policy providing coverage for a "covered claim."[79] In most instances, this ex-

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[76]White v. Woolery Stone Co., 181 Ind. App. 532, 396 N.E.2d 137 (1979); Perez v. United States Steel Corp., 172 Ind. App. 242, 359 N.E.2d 925 (1977); Runion v. Indiana Glass Co., 98 Ind. App. 453, 16 N.E.2d 961 (1938); Sumpter v. Colvin, 98 Ind. App. 453, 190 N.E. 66 (1934).

[77]The Missouri Court of Appeals creatively side-stepped this issue in the decision of Hankins Const. v. Missouri Ins. Guar. Ass'n., 724 S.W.2d 583 (Mo. App. 1986). The MIGA argued that an award for "permanent partial disability" was not a covered claim since the award was not directly traceable to either medical expenses or lost wages as required by the Missouri Act. The *Hankins* court, while recognizing that an award for permanent partial disability could be made even though an injury would have no affect upon the employee's earning capacity, nonetheless found that an award of permanent partial disability constituted "lost income" under the Missouri Act. The *Hankins* court further rejected the MIGA's suggestion that a separate hearing or judicial determination should be required in order to determine what amount of the permanent partial disability award was attributable to lost earnings. *Id.* at 588.

[78]*See supra* note 60.

[79]IND. CODE § 27-6-8-11(a) (1982) provides:

Any person having a claim against an insurer under any provision in an insurance

haustion requirement will result in the injured party pursuing a first-party claim against his uninsured motorist coverage.[80] The majority of uninsured motorist provisions contain express contractual language permitting the carrier, to the extent of payment, to become subrogated to the rights of the injured party against a third-party tortfeasor.[81]

The IIGA Act expressly provides that "any amount due any reinsurer, insurer, insurance pool, or underwriting association, as subrogation recoveries or otherwise" is not a "covered claim" under the Act.[82] Rather, the insurance company's only avenue through which to enforce its subrogation rights is to assert a claim as a creditor directly with the receiver or liquidator of the insolvent insurer.[83] Furthermore, the Indiana Act expressly precludes a solvent insurer from pursuing its subrogation rights against the insured of an insolvent insurer.[84]

1. Constitutionality.—Only five jurisdictions permit a subrogated insurance carrier to recover some, or all, of its subrogation claim against the guaranty association.[85] The remaining jurisdictions, similar

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> policy other than a policy of an insolvent insurer which is also a covered claim, shall be required to exhaust first his right under the policy. Any amount payable on a covered claim under this chapter shall be reduced by the amount of recovery under the insurance policy.

[80]*See infra* text accompanying notes 153-70.

> [81]The policy or endorsement affording the coverage specified in this chapter may also provide that payment to any person of sums as damages under such coverage shall operate to subrogate the insurer to any cause of action in tort which such person may have against any other person or organization legally responsible for the bodily injury or death, or property damage, because of which such payment is made, and the insurer shall be subrogated to the extent of such payment, to the proceeds of any settlement or judgment that may later result from the exercise of any rights of recovery of such person against any person or organization legally responsible for said bodily injury or death, or property damage, for which payment is made by the insurer. Such insurer may enforce such rights in its own name or in the name of the person to whom payment has been made, as in their interest may appear, by proper action in any court of competent jurisdiction.

IND. CODE § 27-7-5-6 (Supp. 1987).

[82]IND. CODE § 27-6-8-4(4) (1982).

> [83][A] claim for any such amount [subrogation recovery or otherwise], asserted against a person insured under a policy issued by an insurer which has become an insolvent insurer, which if it were not a claim by or for the benefit of a reinsurer, insurer, insurance pool or underwriting association, would be a 'covered claim' may be filed directly with the receiver or liquidator of the insolvent insurer . . . .

Id.

[84]The Act states: "[I]n no event may any such claim [subrogation recovery or otherwise] be asserted in any legal action against the insured of such insolvent insurer . . . ." *Id.*

[85]California's Act provides that:

to Indiana, expressly exclude subrogation claims from the definition of "covered claims" under the guaranty association statute.

The constitutionality of such an exclusion was recently challenged in the decision of *California Union Insurance Co. v. Central National Insurance Co. of Omaha*.[86] In concluding that such an exclusion was constitutional, the California Court of Appeals noted:

> The Legislature chose to provide a limited form of protection for the public, not a fund for the protection of other insurance companies from the insolvencies of fellow members. In comments upon a similar provision, excluding from coverage the claims of other insurers by subrogation or otherwise, the drafters of the National Association of Insurance Commissioners Insurance Guaranty Association Model Bill stated, "the subcommittee does not feel that coverage should be extended to elements of the insurance industry which know or reasonably can be expected to know the financial condition of various companies." The Legislature's choice to provide coverage only to the original claimant under the policy is rational and constitutional.[87]

2. *Other Subrogation Rights or Liens.*—The Act carefully restricted the subrogation exclusion to "any reinsurer, insurer, insurance pool, or underwriting association."[88] Thus, other subrogation and lien provisions in federal[89] and state[90] statutes and regulations apparently

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> A member insurer may recover in subrogation from the association only one-half of any amount paid by such insurer under uninsured motorist coverage for bodily injury or wrongful death (and nothing for a payment for anything else), in those cases where the injured person insured by such an insurer has proceeded under his or her uninsured motorist coverage on the ground that the tortfeasor is uninsured as a result of the insolvency of his or her liability insurer . . . provided that such member insurer shall waive all rights of subrogation against such tortfeasor.

CAL. INS. CODE § 1063.2(c)(1) (West Supp. 1987). Georgia allows subrogation if the subrogation insurer has net worth of less than $3,000,000.00. GA. CODE ANN. § 3-36-3(2)(F) (Supp. 1987). Michigan permits subrogation if the net worth of the member insurer is less than 1/10 of 1 percent of aggregate premiums written by member insurers during the preceding calendar year. MICH. COMP. LAWS ANN. § 500.7925(3) (West 1983). Both New York and Wisconsin contain no language in their statutes prohibiting subrogation.

[86]117 Cal. App. 3d 729, 172 Cal. Rptr. 35 (1981).

[87]*Id.* at 734.

[88]IND. CODE § 27-6-8-4(4) (1982).

[89]*See, e.g.*, 42 U.S.C. § 1395(y)(b)(1) (1983) (subrogating the United States to the extent of any payments made under Medicare to the recipient's cause of action against any liable third party); 38 U.S.C. § 629 (1983) (subrogating the United States to the extent of any payment made to a veteran to the extent of the veteran's rights against a third-party tortfeasor); 5 U.S.C. § 8131 (1983) (subrogating the United States to the extent

were not intended to be included within the exclusion. Once again, it will be up to the Indiana courts to determine whether the federal government, state government and other private individuals may pursue subrogation claims under the IIGA for medical-related and wage benefits provided to injured parties.

3. *Subrogation Rights Against the Insured of the Insolvent Insurer.*—Finally, Indiana's Act expressly precludes an insurer from enforcing its subrogation rights directly against an insured of an insolvent insurance company.[91] Other jurisdictions have reached a similar conclusion, either through express statutory language in the Guaranty Association Act[92] or by judicial fiat.[93] The statutes and judicial decisions are problematic because they provide a negligent tortfeasor with additional protection which was not present under his original insurance policy.

In choosing the bodily injury and property damage limits in a liability policy, the insured determines the dollar value of risk for which he will carry insurance, as well as the dollar value of risk which he will self insure. Unless the insured can demonstrate that the insurer

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of any medical benefits paid to an injured employee to the employee's rights against a third-party tortfeasor); 42 U.S.C. § 2651 (1983) (creating subrogation rights in the United States to cover all instances in which the United States is authorized or required by law to furnish hospital, medical, surgical or dental care and treatment to a person who is injured or suffers a disease under circumstances creating a tort liability upon some third person).

[90]*See, e.g.*, IND. CODE § 12-1-7-24.6 (1982) (providing the Indiana State Department of Public Welfare with a lien, to the extent of Medicaid benefits paid, on any recovery from a third-party tortfeasor or insurance company); IND. CODE § 32-8-26-3 (Supp. 1987) providing that any private or state-owned hospital has a lien for all reasonable and necessary charges for hospital care, treatment, or maintenance of a patient upon any cause of action, suit, or claim accruing to the patient, that necessitated the hospital care, treatment or maintenance; IND. CODE § 32-8-38-2 (Supp. 1987) (creating in an emergency ambulance service a lien for all reasonable and necessary charges upon any action, suit or claim accruing to the patient because of illness or injuries that gave rise to the cause of action, and necessitated the provisions of emergency ambulance services); IND. CODE § 12-5-6-9 (Supp. 1987) (creating subrogation rights in the State Department of Public Welfare for any hospital care afforded to indigents against any other person who is liable for the illness or injury for which assistance was granted); IND. CODE § 16-7-3.6-8(c) (1984) (subrogating the State of Indiana to the extent of any payment made under the Compensation for Victims of Violent Crimes Fund to the rights of the victim against the perpetrator of the crime or any person liable for the pecuniary loss resulting from the crime).

[91]IND. CODE § 27-6-8-4(4) (1982).

[92]*See, e.g.*, FLA. STAT. ANN. § 631.54(3) (West 1984) (providing that "Member insurers shall have no right of subrogation against the insured of any insolvent member."); OHIO REV. CODE ANN. § 3955.01(B)(2) (Supp. 1986).

[93]Sandson's Bakery v. Glover, 162 N.J. Super. 225, 392 A.2d 640 (1978).

was guilty of negligence or bad faith in its settlement attempts,[94] any judgment in excess of the insurer's policy limits will be the financial responsibility of the insured. This personal financial responsibility extends to both original claims by injured persons, as well as the subrogation claims of insurance companies who have been forced to provide coverage to the injured parties due to the tortfeasor's conduct.

The Indiana Act's preclusion of subrogation actions against an insured of an insolvent carrier insulates the insured from personal liability vis-a-vis subrogated insurance companies. This, in turn, affords the insured much greater protection than was afforded, or even contemplated under his insurance policy.

A logical alternative to Indiana's approach could be to permit subrogation actions against the insured to the extent that the claim is outside of the coverage limits afforded by the policy issued by the insolvent insurer. This type of approach has been embraced within the Iowa Guaranty Association Act.[95] This would protect the tortfeasor to the same extent as the insurance policy which he purchased, and would also protect subrogated insurance companies from bearing the brunt of another carrier's insolvency.

D. The Medical Malpractice Act

IIGA's limit of liability and restriction of recoverable damages also raises serious questions concerning a medical malpractice claim against a qualified health care provider whose insurance carrier has become insolvent. The Indiana Medical Malpractice Act[96] provides that a health care provider can become qualified under the Act by paying the applicable surcharge and by filing proof of financial responsibility with the Commissioner of Insurance, which can include proof that the health care provider is insured by a policy of malpractice liability insurance in the minimum amount of $100,000.00 per occurrence, and an annual aggregate which is dependent upon the function performed by the health care provider.[97] A qualified health care provider's liability for

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[94]Under Indiana law, "a liability insurer, having assumed control of the right of settlement of claims against the insured, may become liable in excess of its policy limit if it fails to exercise due care in representing its insured." Bennett v. Slater, 154 Ind. App. 67, 70, 289 N.E.2d 144, 146 (1972).

[95]The Iowa Act provides that there can be no subrogation actions against the insured "except to the extent that the claim is outside the coverage of the policy issued by the insolvent insurer." Iowa Code Ann. § 515(B).3 (Supp. 1987).

[96]Ind. Code § 16-9.5-1-1 to -10-4 (1982 & Supp. 1987).

[97]Ind. Code § 16-9.5-2-1, 16-9.5-2-6(a)(1) (1982 & Supp. 1986).

an occurrence of malpractice is limited to $100,000.00.[98] Any judgment or settlement, which is in excess of the health care provider's liability of $100,000.00, is then recoverable from the patient's compensation fund.[99] The patient's compensation statute, in turn, provides that no damages can be recovered thereunder until the health care provider or its insurer has paid its policy limits of $100,000.00,[100] or its annual aggregate has been exhausted.[101]

Neither the Medical Malpractice Act nor the IIGA Act offer any guidance whatsoever concerning how a claim should be handled against a qualified health care provider where that provider's medical malpractice carrier becomes insolvent. Technically, a health care provider is deemed qualified upon providing proof of malpractice insurance in the minimum amount of $100,000.00 per claim.[102] Does that health care provider remain qualified under the Act and subject to maximum liability of $100,000.00 if his medical malpractice insurer becomes insolvent? Alternatively, does the carrier's insolvency remove the health care provider from "qualified" status, thereby subjecting him to unlimited liability?

Given the Act's stated purpose of avoiding excessive financial loss to policyholders because of the insolvency of an insurer, a persuasive argument could be made that the health care provider should remain qualified under the Indiana Act. If this is the correct interpretation, does the Act's limit of liability of $49,900.00 preclude an injured party from ever gaining access to the patient's compensation fund, which under certain circumstances could involve a potential recovery of an additional $400,000.00?[103] After all, access to the patient's compensation fund is strictly limited to those situations where a qualified health care provider has paid $100,000.00, or the annual aggregate limit has been exhausted.[104]

Completely blocking an injured patient's access to the patient's compensation fund would appear contrary to the stated purpose of the IIGA Act to avoid excessive financial loss to claimants because of the insolvency of an insurer. If the courts determine that the $49,900.00

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[98]IND. CODE § 16-9.5-2-2(b) (1982). The Act further provides, however, that in the event that the annual aggregate has been paid by or on behalf of the qualified health care providers, all sums which may thereafter become due and payable to a claimant arising out of an act of malpractice shall be paid during that year from the Patients Compensation Fund. IND. CODE § 16-9.5-2-7 (1982).

[99]IND. CODE § 16-9.5-2-2(c) (1982).

[100]IND. CODE § 16-9.5-4-3 (1982).

[101]IND. CODE § 16-9.5-2-7 (1982).

[102]IND. CODE § 16-9.5-2-6 (Supp. 1987).

[103]*See* IND. CODE § 16-9.5-2-2 (1982).

[104]*See supra* notes 98-101 and accompanying text.

limit under the Act does not preclude an injured patient's access to the patient's compensation fund, at what dollar level does the compensation fund become operable? Subject to the $500,000.00 limitation,[105] does the patient's compensation fund become operable upon the IIGA's payment of $49,900.00 to the injured patient? The resolution of these issues will likewise require Indiana courts to carefully scrutinize the stated goal and purpose behind both the IIGA Act and the Medical Malpractice Act.

III. Presentation of Covered Claim Under the Act

To determine whether the Act will afford protection to a particular claimant, it is necessary to determine whether the asserted claim falls within the definition of a "covered claim" outlined in Indiana Code section 27-6-8-4(4). The claimant should also review the exclusionary language of that definition which eliminates certain claims from coverage under the Act even though they otherwise fall within the definition of a "covered claim."[106] Once it is determined that a particular claim is covered by the Act, it is extremely important to assure that the claim is properly filed in the liquidation proceeding of the insolvent insurer. The Act states that a "covered claim" within the meaning of the Act shall not include:

> [A]ny unpaid claim or judgment not filed timely or properly in the liquidation proceedings in accordance with the provisions of IC 27-1-4 [repealed][107] if the insolvent insurer is a domestic insurer or in accordance with the applicable provisions of the law of the state of domicile if the insolvent insurer is not a domestic insurer.[108]

As a result, the Act specifically excludes from the definition of a "covered claim" any claims which are not properly filed. Therefore, it is important to comply with any and all requirements for the filing of claims relating to insolvent insurers. Every practitioner should carefully review and assure compliance with all current statutory requirements which might relate to the filing of such claims. It is necessary not only to comply with Indiana's statutes concerning the filing of

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[105] Ind. Code § 16-9.5-2-2 (1982).

[106] Ind. Code § 27-6-8-4(4) (1982).

[107] This chapter, concerning rehabilitation, liquidation and conservation, was repealed by Acts 1979, P.L. 255, § 3. For present provisions, see Ind. Code § 27-9-1-1 to 27-9-4-10 (1982 & Supp. 1986).

[108] Ind. Code § 27-6-8-4(4) (1982).

such claims,[109] but it is also necessary to comply with all applicable provisions of the law of the state of domicile of the insolvent insurer if the insolvent insurer is not a domestic insurer.[110]

Upon entry of an order of liquidation of a domestic insurer,[111] the liquidator appointed by the court, unless otherwise directed, is required to give notice by first class mail as soon as possible to all persons known or reasonably expected to have claims against the insurer, at their last known address as indicated by the records of the insurer.[112] The liquidator is also required to provide notice of the liquidation as soon as possible by "publication in a newspaper of general circulation in the county in which the insurer has its principal place of business and all other locations the liquidator considers appropriate."[113] The notice to potential claimants shall require the claimants to file, along with proper proof, their claims and shall state a deadline for the filing of such claims.[114] Proof of all claims must be filed with the liquidator on or before the last date for filing specified in the notice.[115] Claims which are filed after the deadline set by the liquidator and identified in the notice are assigned a lower priority for the distribution of assets from the insurer's estate than are claims which are filed on time.[116]

Any third party alleging a cause of action against the insured of an insurer in liquidation may file a claim with the liquidator.[117] However, whether the third party files such a claim, the insured against whom such claims are asserted may file a claim on his own behalf in the liquidation proceedings.[118]

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[109]*See supra* note 108 and accompanying text. *See also* Ind. Code § 27-6-8-7(a)(i)(2) (1982). For Indiana's statutory requirements relating to the assertion of such a claim, see Ind. Code §§ 27-9-3-10, 27-9-3-33, and 27-9-3-34 (1982).

[110]Ind. Code § 27-6-8-4(4) (1982). *See also* Ind. Code §§ 27-9-4-3(c), 27-9-4-7 (1982).

[111]*See* Ind. Code § 27-9-3-6, to -7 (1982). An order to liquidate the business of a domestic insurer must appoint the Commissioner of Insurance (and his successors in office) as liquidator. Ind. Code § 27-9-3-7(a)(1) (1982).

[112]Ind. Code § 27-9-3-10(a)(4) (1982).

[113]*Id.* § 27-9-3-10(a)(6) (1982). *See also* §§ 27-6-8-9(b)(i), 27-6-8-7(a)(v) (1982).

[114]*Id.* § 27-9-3-10(b).

[115]*Id.* § 27-9-3-33(a). *See also* Middleton v. Imperial Insurance Co., 34 Cal. 3d 134, 193 Cal. Rptr. 144, 666 P.2d 1 (1983), holding that a liquidator who failed to give notice of the time for filing claims, as required by statute, is estopped from asserting the time limitation contained in the notice against late filers who did not receive the required notice.

[116]*See* Ind. Code §§ 27-9-3-40(3) (timely filed claims), § 27-9-3-40(6) (1982) (claims filed late).

[117]*Id.* § 27-9-3-36(a).

[118]*Id.* § 27-9-3-36(b).

A proper proof of claim must contain certain specific information and must be signed by the claimant.[119] At a minimum, the proof of claim must include the following information:

1. The particulars of the claim including the consideration given for it.
2. The identity and amount of the security on the claim.
3. The payments made on the debt, if any.
4. That the sum claimed is justly owed and that there is no setoff, counterclaim, or defense to the claim.
5. Any right of priority of payment or other specific right asserted by the claimants.
6. A copy of written instrument that is the foundation of the claim.
7. The name and address of the claimant and the attorney who represents him, if any.[120]

The liquidator may require that additional information or documents be provided by the claimant.[121] In addition, the liquidator may require that claims be asserted on a prescribed form.[122] After receiving a properly filed claim from a third party having a covered claim against any insured of the insolvent insurer, the liquidator must immediately forward the claim to the IIGA for processing in accordance with the provisions of the Act.[123]

In the event of the insolvency of an insurer who is not domiciled in the state of Indiana, the Commissioner of Insurance may file a petition requesting his appointment as an ancillary liquidator[124] if the Commissioner finds that "there are sufficient assets of the insurer located in Indiana to justify the appointment of an ancillary liquidator and the protection of the creditors or policyholders in Indiana requires such appointment."[125] In the event of the appointment of an ancillary receiver within the state of Indiana, Indiana claimants may file their claims either with the ancillary receiver in Indiana or with the appointed

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[119] *Id.* § 27-9-3-34.
[120] *Id.* § 27-9-3-34(a)(1)-(7).
[121] *Id.* § 27-9-3-34(b).
[122] *Id.*
[123] IND. CODE § 27-6-8-7(a)(i)(2) (1982).
[124] *See* IND. CODE § 27-9-1-2(a) and (o) (1982).
[125] *Id.* § 27-9-4-4(a).

liquidator in the liquidation proceeding in the reciprocal state.[126] Such claims must be filed on or before the last date fixed for the filing of such claims in the liquidation proceedings of the domiciliary state.[127] If no ancillary receiver has been appointed within the state of Indiana relative to the liquidation of an insurer not domiciled in the state of Indiana, it would appear necessary to assert claims pursuant to the laws of the state of domicile of the insolvent insurer or the laws of the state where any liquidation proceeding is pending.

The Act requires a claimant to exhaust his rights under applicable policies of insurance other than the insolvent insurer.[128] Any amounts payable as a covered claim pursuant to the Act shall be reduced by the amount of recovery from such other insurance policies.[129] For this reason, it is important for a claimant to carefully examine the possible existence of any other applicable insurance coverage and assert timely claims against that coverage.[130] The Act also requires that under certain situations a claimant must first assert claims against the guaranty associations of other states.[131] If a claimant fails to timely assert his claims against other applicable guaranty associations or insurance policies, he runs the risk of voiding any applicable coverage which might be afforded by the Act.

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[126]*Id.* § 27-9-4-7(a). A reciprocal state is defined by IND. CODE § 27-9-1-2(p) (1982) as:

> any state other than Indiana in which:
> (1) in substance and effect IC 27-9-3-7(a), IC 27-9-4-3, IC 27-9-4-4, and IC 27-9-4-6 through IC 27-9-4-8 are in force;
> (2) provisions are in force requiring that the commissioner (or equivalent official) be the receiver of a delinquent insurer; and
> (3) some provision exists for the avoidance of fraudulent conveyances and preferential transfers.

[127]*Id.* § 27-9-4-7(a). Domiciliary state is defined as "the state in which an insurer is incorporated or organized, or, in the case of an alien insurer, its state of entry." *Id.* § 27-9-1-2(f).

[128]IND. CODE § 27-6-8-11(a) (1982).

[129]*Id.*

[130]*See supra* text accompanying notes 39-40, and *infra* text accompanying notes 140-170.

[131]
> Any person having a claim which may be recovered under more than one (1) insurance guaranty association or its equivalent shall seek recovery first from the association of the place of residence of the insured except that if it is a first party claim for damage to property with a permanent location, he shall seek recovery first from the association of the location of the property, and if it is a workmen's compensation claim, he shall seek recovery first from the association of the residence of the claimant. Any recovery under this chapter shall be reduced by the amount of recovery from any other insurance guaranty association or its equivalent.

IND. CODE § 27-6-8-11(b) (1982).

The Act allows for a stay of any action pending in a court of the state of Indiana in all proceedings in which the insolvent insurer is a party or is obligated to defend a party.[132] The language of this statute allowing for a stay is mandatory and provides an automatic right to a stay of at least six months. The Act defines an insolvent insurer as:

> a member insurer holding a valid certificate of authority to transact insurance in this state either at the time the policy was issued or when the insured event occurred and (b) *against whom a final order of liquidation*, with a finding of insolvency, to which there is no further right of appeal, *has been entered by a court of competent jurisdiction in the company's state of domicile.*[133]

Based upon this definition of an "insolvent insurer," the automatic stay is available in all actions pending in Indiana courts regardless of whether the liquidation proceeding against the insolvent insurer is pending within the state of Indiana or some other state.

In addition to the automatic stay, the Act specifically authorizes the IIGA to petition the court to set aside "any decision, verdict or finding based on the default of the insolvent insurer or its failure to defend an insured . . . ."[134] The Act states that upon the filing of a petition by the IIGA to set aside such a default judgment, the association "*shall* be permitted to defend against the claim on the merits."[135] Similarly, the statute relating to the filing of a proof of claim in the liquidation proceeding states that "[a] judgment or order against an insured or the insurer entered at any time by default or by collusion"[136] need not "be considered as evidence of liability or the measure of damages."[137] The same statute mandates that "[a] judgment or order against an insured or the insurer entered not more than four [4] months before the filing of the petition [for liquidation]"[138] need not be con-

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> [132]All proceedings in which the insolvent insurer is a party or is obligated to defend a party in court in this state *shall be stayed* for up to six [6] months and such additional time thereafter as may be determined by the court from the date the insolvency is determined or an ancillary proceeding is instituted in the state whichever is later to permit proper defense by the association of all pending causes of action.

Id. § 27-6-8-17 (emphasis added). *See also* Ind. Code § 27-9-4-4 (1982) (relating to the institution of ancillary proceedings for insolvent insurers which are not domiciled in Indiana).

[133]Ind. Code § 27-6-8-4(5) (1982) (emphasis added).

[134]Ind. Code § 27-6-8-17 (1982).

[135]*Id.* (emphasis added).

[136]Ind. Code § 27-9-3-34(d)(2) (1982).

[137]*Id.* § 27-9-3-34(d).

[138]*Id.* § 27-9-3-34(d)(3).

sidered as evidence of liability or the measure of damages. As a result, any judgment against the insolvent insurer or its insured is of little value if the judgment was obtained by default or within four months prior to the filing of the liquidation petition.

IV. A Closer Look at Specific Problems Under the Act

As noted by the *Kiner* court, due to substantial similarities between Indiana's Act and the guaranty association acts of other jurisdictions, the Indiana courts will look to the case law of other jurisdictions for guidance in construing the Indiana Act.[139] Numerous decisions from other jurisdictions will lend helpful guidance to the Indiana courts in addressing various issues which will arise under the Indiana Act.

A. *Exhaustion of Remedies Under Other Insurance Policies*

The *Kiner* court noted that "[t]he Insurance Guaranty Law also requires that a claimant or policyholder first exhaust his rights against any other applicable insurance policies or guaranty associations . . . ."[140] The exhaustion of remedies provisions of the Indiana Act provide as follows:

> Any person having a claim against an insurer under any provision in an insurance policy other than a policy of an insolvent insurer which is also a covered claim, shall be required to exhaust first his right under the policy. Any amount payable on a covered claim under this chapter shall be reduced by the amount of recovery under the insurance policy.[141]

Two concepts arise out of this provision. First, the exhaustion requirements are limited to claims arising under a provision in an insurance policy. As will become apparent, this limitation will have important ramifications, from the standpoint of both first-party and third-party claims. Second, the exhaustion requirements are expressly restricted to the notion of a "covered claim." A "covered claim" must arise out of an insurance policy to which the Act applies. Thus, the exhaustion of remedies requirements will not be applicable to those kinds of insurance which are excluded from the Act: "life, title, surety, disability, accident and sickness, health care, credit, mortgage guaranty, and ocean marine insurance."[142]

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[139]Indiana Ins. Guar. Ass'n v. Kiner, 503 N.E.2d 923, 925 n.4 (Ind. Ct. App. 1987).
[140]*Id.* at 925.
[141]Ind. Code § 27-6-8-11(a) (1982).
[142]*Id.* § 27-6-8-3.

In addressing questions concerning the exhaustion of remedies requirement of the Act, it is recommended that a three-step approach be utilized:

(1) First, identify the parties involved and the nature of their claims against the IIGA. In the third-party context, the tortfeasor/insured will be making a claim against the IIGA to satisfy his insolvent carrier's duty to defend and indemnify; the injured third party will be making a claim against the tortfeasor/insured, in an attempt to invoke the IIGA's indemnity obligations on behalf of the tortfeasor. In the first-party context, the injured insured will be making a claim against the IIGA to satisfy the indemnity obligations that the insolvent carrier owed directly to the insured;

(2) Second, identify whether the party would be making a claim against a collateral source in his capacity as a named or additional insured under another policy of insurance. If this is the case, then the other policy of insurance would be subject to the exhaustion requirement. If, on the other hand, the party is a stranger to the collateral insurance policy and would be pursuing a claim against a third party who is an insured under the collateral insurance, then the exhaustion requirement would not be applicable;[143] and

(3) Third, if a claim under an insurance policy is involved, is the type of insurance involved subject to the purview of the Act? If the collateral insurance involves life, title, surety, disability, accident and sickness, health care, credit, mortgage guaranty, or ocean marine insurance, the exhaustion requirements would not be applicable.[144]

1. Third-Party Claim—Tortfeasor's Exhaustion Requirements.— As previously noted, in the third-party context, the tortfeasor/insured's claim against the IIGA is to enforce the insolvent carrier's defense and indemnity obligations under his policy of insurance. The IIGA is required to step into the shoes of the insolvent insurer and to defend and indemnify the tortfeasor/insured for the "covered claim" of the injured third-party.[145]

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[143] *See id.* § 27-6-8-11(a).

[144] *See id.* §§ 27-6-8-3, -11(a).

[145] Ind. Code § 27-6-8-7(a)(ii) (1982), provides that the IIGA shall:

Be deemed the insurer to the extent of its obligation on the covered claims as limited by this chapter and to this extent shall have all rights, duties, and obligations of the insolvent insurer as if the insurer had not become insolvent, including those relating to reinsurance contracts and treaties entered into by the

Thus, the only collateral insurance which the tortfeasor/insured would be required to exhaust under the Act would be under any secondary insurance which would provide defense and indemnification to the tortfeasor for purposes of the covered claim of the injured third-party.

This scenario will not arise in the context of a true "excess" or "umbrella" policy, since those policies specifically exclude any liability below a specified retained limit. The situations will arise, however, where the tortfeasor is concurrently covered by two or more different insurance policies, and one of the carriers becomes insolvent.

The decision of *Ross v. Canadian Indemnity Insurance Co.*[146] addresses this type of situation. In *Ross*, the plaintiff suffered personal injuries when he was loading drums of acid onto a truck. The plaintiff sued the property owner. At the time of the accident, the property owner's premises were insured through Signal/Imperial Insurance. The property owner was also named as an additional insured in the truck-owner's policy with Canadian Indemnity for "injuries occurring during the loading and unloading of the vehicle."[147]

Pursuant to the California Insurance Code, the premises insurer provided primary coverage, while the truck-owner's insurer provided excess coverage. Before the resolution of the underlying action, the premises insurer became insolvent. The tortfeasor then requested that the truck-owner's insurer tender a defense to it, arguing that that policy became primary upon the insolvency of the premises insurer. When the truck-owner's insurer refused to tender a defense, the California Guaranty Association undertook the defense, and entered into a stipulated judgment in favor of the plaintiff in the amount of $50,000.00. The tortfeasor and the California Guaranty Association then assigned to the plaintiff their rights against the truck-owner's insurer. The plaintiff then initiated suit against the truck-owner's insurer, claiming third-party beneficiary status as a result of the agreement.[148]

The *Ross* court concluded:

> [W]hen a secondary insurer is available in the event of an insolvent primary insurer, the secondary insurer should be responsible in the absence of specific language to the contrary.

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insolvent insurer. However, the association's obligation to defend any insured of the insolvent insurer or to indemnify against the costs of such defense terminates as soon as the claimant or claimants have been paid all benefits that they are entitled to under this chapter.

[146]142 Cal. App. 3d 396, 191 Cal. Rptr. 89 (1983).

[147]*Id.* at 399, 191 Cal. Rptr. at 100.

[148]*Id.* at 399-400, 191 Cal. Rptr. at 100-01.

> The secondary insurer has received a premium for the risk and thus the secondary insurer, and not CIGA [California Insurance Guaranty Association], should be responsible for the coverage of the loss.[149]

A similar situation which is also ripe for controversy in this context will involve commercial vehicles subject to a leasing agreement, where the lessee and lessor each carry liability insurance providing coverage to the leased vehicle.[150] One would expect this to be a recurring problem, especially in light of the increased use of trip-lease agreements in the commercial community.[151]

2. *Third-Party Liability—Injured Party's Exhaustion Requirements.*—In this context, the injured party is pursuing a third-party claim against a tortfeasor/insured whose liability insurance company has become insolvent. There is apparently widespread confusion concerning what other insurance, if any, the injured party must initially exhaust as a condition precedent to gaining access to the IIGA's duty to indemnify the tortfeasor/insured of the insolvent carrier.

a. *Uninsured Motorist Coverage*

Numerous decisions from other jurisdictions have concluded that an injured party must first exhaust the coverage available under the uninsured motorist provisions of his own insurance policy, prior to proceeding against the guaranty association.[152] In *Kentucky Insurance Guaranty Association Mutual v. State Farm Automobile Insurance Co.*,[153] plaintiffs who suffered injuries in an automobile accident filed suit against the driver of the other vehicle. The other driver's insurance company was adjudged to be insolvent by an Illinois court. The Kentucky Guaranty Association demanded that the plaintiffs initially exhaust the limits of the uninsured motorist coverage provided by their own policy before they could pursue any claim under the Kentucky

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[149]*Id.* at 404, 191 Cal. Rptr. at 104.

[150]For a discussion concerning which insurance carrier provides primary coverage to the leased vehicle, see Ryder Truck Lines v. Carolina Cas. Ins. Co., 270 Ind. 315, 385 N.E.2d 449 (1979); American Underwriters, Inc. v. Auto-Owners Mut. Ins. Co., 454 N.E.2d 876 (Ind. Ct. App. 1983); IND. CODE §§ 27-8-9-7 to -9 (Supp. 1987).

[151]*See* Redieks Exp., Inc. v. Maple, 491 N.E.2d 1006, 1010-11 (Ind. Ct. App. 1986).

[152]*See, e.g.*, King v. Jordan, 601 P.2d 273 (Alaska 1979); Spearman v. State Sec. Ins. Co., 57 Ill. App. 3d 393, 372 N.E.2d 1008 (1978); Kentucky Ins. Guar. Ass'n v. State Farm Auto Ins. Co., 689 S.W.2d 32 (Ky. Ct. App. 1985); Vokey v. Massachusetts Insurers Insolvency Fund, 381 Mass. 386, 409 N.E.2d 783 (1980); Henninger v. Riley, 317 Pa. Super. 570, 464 A.2d 469 (1983); Sands v. Pennsylvania Ins. Guar. Ass'n, 283 Pa. Super 217, 423 A.2d 1224 (1980); Prutzman v. Armstrong, 90 Wash. 2d 118, 579 P.2d 359 (1978).

[153]689 S.W.2d 32 (Ky. Ct. App. 1985).

Insurance Guaranty Association Act. The plaintiffs' insurance company denied that it was liable to provide plaintiffs uninsured motorist coverage.[154]

The court initially noted that the plaintiffs' policy of insurance defined an uninsured motor vehicle to include "[a] land motor vehicle . . . with respect to which there is a bodily injury liability bond or insurance policy applicable at the time of the accident but the company writing the same . . . is or becomes insolvent."[155] This policy language was substantially identical to the Kentucky uninsured motorist statute which provided that "an 'uninsured motor vehicle' shall be deemed to include any insured motor vehicle the liability insurer of which cannot pay a legal liability due to insolvency."[156]

The court then considered the exhaustion of remedies language in the Kentucky Insurance Guaranty Association Act which provided that "[a]ny person having a claim against his insurer under any provision in his insurance policy which is also a covered claim shall be required to exhaust first his right under such policy."[157] The court concluded that such language was intended to require insureds to exhaust their right to recover sums due under the uninsured motorist coverage portion of their own liability insurance policy as a condition precedent to pursuing a "covered claim" against the association.[158]

A similar result was reached by the Superior Court of Pennsylvania in the decision of *Henninger v. Riley*.[159] The *Henninger* court construed an "exhaustion of remedies" provision in the Pennsylvania Insurance Guaranty Association Act which is identical to the exhaustion of remedies provision in Indiana's Act. Construing this provision, the *Henninger* court concluded that the Pennsylvania Guaranty Association Act required the plaintiffs to first exhaust their rights under the uninsured motorist coverage afforded by their policy before proceeding against the guaranty association. The *Henninger* court further stressed that the exhaustion of benefits under the uninsured motorist coverage precedes the creation of any obligation on the part of the guaranty association to step into the shoes of the insolvent insurer.[160]

It is also important to note that the entire limits of the uninsured motorist coverage must be exhausted as a condition precedent to pursuing a claim under the Guaranty Association Act. In *Prutzman v.*

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[154]*Id.* at 33-34.
[155]*Id.* at 34.
[156]*Id.*
[157]*Id.* at 35.
[158]*Id.*
[159]317 Pa. Super. 570, 464 A.2d 469 (1983).
[160]*Id.* at 675-77, 464 A.2d at 472-73.

Armstrong,[161] the plaintiff was injured in an automobile accident. She initiated suit against the other driver, such suit resulting in a settlement for the other driver's bodily injury limits of $15,000.00. After receiving notice of the insolvency of the other driver's carrier, the plaintiff and other driver nonetheless proceeded to submit a stipulated judgment for $15,000.00 which was approved by the court.[162]

Thereafter, the plaintiff instituted a declaratory judgment action against her insurance company, which had issued uninsured motorist coverage with a $15,000.00 limit, and the Washington Insurance Guaranty Association.[163] The trial court determined that the plaintiff could accept $12,600.00 from her insurance carrier and recover the $2,400.00 difference (less the $100.00 deductible) from the Washington Insurance Guaranty Association.[164] On appeal, the *Prutzman* court determined that plaintiff's settlement for less than the policy limits of her uninsured motorist coverage was inadequate to constitute exhaustion under the Insurance Guaranty Association Act.[165]

Louisiana stands alone as the only jurisdiction which does not require an exhaustion of uninsured motorist benefits before an injured party can proceed against the guaranty association. In *Hickerson v. Protective National Insurance Co.*,[166] the Louisiana Supreme Court determined that since the Louisiana Guaranty Association Law provided coverage in lieu of the insolvent insurer, the insured could not be considered "uninsured" for purposes of the plaintiff's uninsured motorist coverage.[167] The *Hickerson* court stated that this conclusion was necessary in order to afford some protection to the insured of the insolvent carrier, who otherwise would have been subject to liability for the subrogation claims of the solvent insurer which had paid the uninsured motorist claim.[168]

It is anticipated that Indiana will likely align itself with the majority of other jurisdictions requiring an injured party to initially exhaust his uninsured motorist coverage prior to proceeding against the IIGA. Indiana's uninsured motorist statute specifically provides that an "'uninsured motor vehicle' . . . includes an insured motor vehicle where the liability insurer of the vehicle is unable to make payment with respect to the legal liability of its insured within the limits specified

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[161] 90 Wash. 2d 118, 579 P.2d 359 (1978).

[162] *Id.* at 119-20, 579 P.2d at 361.

[163] *Id.*

[164] *Id.* at 120, 579 P.2d at 361.

[165] *Id.* at 122, 579 P.2d at 362.

[166] 383 So. 2d 377 (La. 1980).

[167] *Id.* at 379-80.

[168] *Id.* at 379.

in IC 9-2-1-15 because of insolvency."[169] Furthermore, the concerns expressed by the *Hickerson* court would not be present in Indiana, since the IIGA Act specifically precludes an insurer from enforcing a subrogation claim directly against the insured of the insolvent carrier.[170]

b. Workmen's Compensation Claim

The Indiana Workmen's Compensation Act permits an injured employee to bring an action against a third-party, subject to the subrogation rights or lien of an employer who has paid benefits.[171] If the third-party tortfeasor's carrier becomes insolvent, will the injured employee be required to exhaust the full extent of workmen's compensation benefits from his employer?

Resolution of this issue requires an analysis of the second prong of the three-part test previously enumerated.[172] Would the employee be making a claim against the workmen's compensation carrier in his capacity as a named or additional insured under the workmen's compensation policy?

A workmen's compensation policy is issued to the employer as the named insured. By the terms of a workmen's compensation policy, the carrier agrees, *inter alia*, to pay on the employer's behalf any benefits which the employer is required to pay employees under the workmen's compensation law. The employee is neither a named nor additional insured under the workmen's compensation policy.[173]

Indiana law has consistently recognized that a third-party stranger to an insurance policy, who is neither a named nor additional insured thereunder, possesses no rights under the insurance policy and cannot maintain a direct action against the insurance company.[174] This type of rationale has been expressly extended to the context of an employee, vis-a-vis a workmen's compensation policy.[175] Thus, the injured em-

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[169]Ind. Code § 27-7-5-4(a) (1982 & Supp. 1987) (1987 supplement version effective Jan. 1, 1988).

[170]Ind. Code § 27-6-8-4(4) (1982) (providing that "in no event may any such claim [subrogation claim of insurer] be asserted in any legal action against the insured of such insolvent insurer").

[171]Ind. Code § 22-3-2-13 (1982).

[172]*See supra* discussion in text p. 231.

[173]*See* Baker v. American States Ins. Co., 428 N.E.2d 1342 (Ind. Ct. App. 1981). In *Baker*, the court noted that an employee was not a third-party beneficiary of an insurance policy issued by a workmen's compensation carrier to the employer. *Id.* at 1347.

[174]Eichler v. Scott Pools, Inc., 513 N.E.2d 665 (Ind. Ct. App. 1987); Winchell v. Aetna Life & Casualty Insurance Co., 182 Ind. App. 261, 394 N.E.2d 1114 (1979); Bennett v. Slater, 154 Ind. App. 62, 289 N.E.2d 144 (1972); Spicklemeir v. T.H. Mastin & Co., 107 Ind. App. 350, 24 N.E.2d 797 (1940).

[175]*Baker*, 428 N.E.2d 1342 (Ind. Ct. App. 1981).

ployee would not have a claim as an insured under the employer's workmen's compensation policy. Rather, the injured employee would have a third-party claim against the employer under the Workmen's Compensation Act. Accordingly, the injured employee would not be required under the IIGA Act to exhaust his remedies under his employer's workmen's compensation coverage precedent to pursuing his claim against the negligent tortfeasor under the IIGA Act.

c. Injured Party's Claim Against Two or More Defendants, One of Whose Liability Insurance Carrier Becomes Insolvent

The situation often arises where an injured party has a cause of action against two or more joint tortfeasors. If the carrier of the first joint tortfeasor becomes insolvent, will the injured party be required to exhaust the policy limits of the second tortfeasor with the solvent carrier prior to proceeding under the Act?

Applying the second prong of the three-part test previously denominated, this question must be answered in the negative.[176] The injured party is not a named or additional insured under the policy of insurance issued to the second tortfeasor by the solvent insurance carrier. Since the injured party has no right to assert a direct action against that insurance company, he should not be required to exhaust the limits of that policy prior to gaining access to the guaranty association fund vis-a-vis the first tortfeasor's insolvent insurer.

This conclusion is supported by the opinion of the Pennsylvania Superior Court in the decision of *Sands v. Pennsylvania Insurance Guaranty Association*.[177] In *Sands*, a passenger suffered personal injury as a result of an automobile collision. The injured party filed an uninsured motorist claim with the carrier providing coverage to the driver of his vehicle, and was paid the full amount of uninsured motorist benefits. The insured passenger also filed an uninsured motorist claim under his own policy and obtained a judgment for the full amount of that coverage. Thereafter, the passenger's insurer became insolvent. The passenger then applied to the Pennsylvania Insurance Guaranty Association for the payment of the amount of his judgment against his insurance company. The guaranty association refused payment, claiming that the passenger had failed to exhaust the insurance coverage available to him vis-a-vis the liability coverage carried by the driver of the vehicle in which the injured party was a passenger at the time of the accident.[178]

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[176]*See supra* discussion in text p. 231.
[177]283 Pa. Super. 217, 423 A.2d 1224 (1980).
[178]*Id.* at 221, 423 A.2d at 1225.

The *Sands* court rejected this argument, noting that while the injured party may have had a claim against the driver, the injured party was not a person having a claim against the driver's insurance company. The court further noted that any claim that the injured party might have had against his driver's insurer under the liability policy would not have been a covered claim, because the claim would not have resulted from the insolvency of the carrier, but from the negligence of the driver.[179]

d. Injured Party's Health Care Coverage

The typical injured third-party will have some form of health care coverage which could pay for medical expenses and hospital costs associated with injuries caused by the tortfeasor/insured of the insolvent insurance company. Under these circumstances, will the injured third-party be required to exhaust the coverage that is available under this health care policy as a condition precedent to gaining access to the IIGA?

The second prong of the three-part analysis previously enumerated would be satisfied,[180] since the injured party would be making a claim as a named or additional insured under his own health care policy. The third prong, however, would not be satisfied because a claim against a health care policy is not a "covered claim" under the Act.[181] As such, the injured third-party would not be required to exhaust the coverage available under his health care policy as a condition precedent to gaining access to the IIGA.

3. *First-Party Context.*—In the first-party context, the injured insured will be making a direct claim for benefits under his own insurance policy. If the injured insured's insurance company becomes insolvent, the IIGA steps into the shoes of the insolvent carrier to the extent of obligations under the insurance policy, subject to the restrictions of the Act.[182]

a. Identical Secondary Coverage

Exhaustion requirements may be applicable in the first-party context where the injured insured had a second policy of insurance available to him as a named or additional insured. For example, a passenger who suffers injuries in an automobile accident between a vehicle being operated by the host driver, and a vehicle being operated by an un-

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[179] *Id.* at 224, 423 A.2d at 1227.

[180] *See supra* discussion in text p. 231.

[181] IND. CODE § 27-6-8-3 (1982) (excepts from coverage health care insurance).

[182] IND. CODE § 27-6-8-7(a)(2)(ii) (1982).

insured tortfeasor, would most likely have an uninsured motorist claim under his own policy of insurance,[183] as well as the host driver's insurance policy.[184] If the passenger's insurance company becomes insolvent, will he be required to exhaust the uninsured motorist coverage available under the host driver's policy as a condition precedent to gaining access to the IIGA?

Resolution of this issue will involve the second and third prongs of the three-part test previously enumerated.[185] The passenger would be making a claim as an "additional insured" under the host driver's policy of insurance. Furthermore, an uninsured motorist claim under the host driver's insurance policy would be a "covered claim" under the Act. Thus, the injured passenger would be required to initially exhaust the host driver's uninsured motorist coverage prior to gaining access to the IIGA.[186]

A similar situation would be presented by a mortgage company which carried its own insurance on the mortgaged property, and which was also denominated as an additional insured under a standard mortgage clause in the homeowner's policy. If the mortgage company's insurer became insolvent, would the mortgage company be required to exhaust its rights under the homeowner's policy prior to gaining access to the IIGA? Such a claim would be presented by the mortgage company as an insured under the homeowner's policy to the extent of the mortgage debt.[187] Additionally, the claim under the homeowner's

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[183]The normal insuring agreement in an uninsured motorist coverage provides that:

> We will pay damages which a covered person is legally entitled to recover from the owner or operator of an uninsured motor vehicle because of bodily injury:
>
> 1. sustained by a covered person; and
> 2. caused by an accident.
>
> The owner's or operator's liability for these damages must arise out of the ownership, maintenance or use of the uninsured motor vehicle. ISU Personal Auto Policy, Form PP-00-1 (Ed. 6/80).

[184]*See* notes 128-29. The term "covered person" is normally defined to include "any other person occupying your covered auto," and would thus qualify the passenger as a "covered person" for purposes of the host driver's uninsured motorists coverage. *See* ISO Personal Auto Policy, Form PP-OO-1 (Ed. 6/80).

[185]*See supra* discussion in text p. 231.

[186] This conclusion seems to have been implicitly reached by the Pennsylvania Superior Court in the decision of Sands v. Pennsylvania Ins. Guar. Ass'n, 283 Pa. Super. 217, 423 A.2d 1224 (1980), on facts identical with the hypothetical presented in the text. The *Sands* court noted that the passenger was a "person having a claim against [the host driver's solvent insurance company], so far as [the host driver's insurance company], provided uninsured motorist coverage." *Id.* at 223, 423 A.2d at 1227. The *Sands* court concluded that the passenger did "exhaust his rights under such policy" as a result of the host driver's insurer's payment of the uninsured motorist limits of $10,000.00. *Id.* at 223, 423 A.2d at 1227.

[187]The standard mortgage clause operates to create a separate and independent insurance

policy would be a "covered claim" under the Act.[188] As such, the mortgage company would be required to first exhaust its rights under the homeowner's standard mortgage clause as a condition precedent to gaining access to the IIGA.

b. Tortfeasor's Liability Coverage

Assume that a third-party operated his vehicle negligently, lost control of the same and caused extensive property damage to a homeowner's residence. The homeowner submits a claim under his homeowner's policy and that insurance company becomes insolvent. Will the homeowner be required to exhaust his rights against the negligent tortfeasor's automobile property damage coverage as a condition precedent to gaining access to the IIGA?

Once again, this question must be answered in the negative. The homeowner's claim would be against the negligent tortfeasor, and not as a named or additional insured under the tortfeasor's policy. Thus, the exhaustion requirements would not be applicable.

c. Health Care Coverage

Assume the situation where an injured passenger is making a claim under his uninsured motorist coverage. If the passenger's automobile insurer becomes insolvent, will the passenger be required to exhaust his rights under his health care policy as a condition precedent to gaining access to the IIGA?

Again, the answer is "no". The claim of the passenger would be presented in his capacity as an "insured" or "additional insured" under his health care policy. However, the claim under the health care policy falls outside the scope of a "covered claim" under the Act.[189] Accordingly, the injured passenger would not be required to exhaust coverage available under his health care policy as a condition precedent to gaining access to the IIGA.

B. Setoff

As a corollary to its "exhaustion of remedies" provisions, the Act also provides that "any amount payable on a covered claim under this chapter shall be reduced by the amount of recovery under the insurance policy."[190] The term "insurance policy" is modified by the "exhaustion

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policy between the mortgagee and the insurance company of the homeowner. Federal Nat. Mtg. Ass'n v. Great American Ins. Co., 157 Ind. App. 347, 300 N.E.2d 117 (1973).

[188] *See* Hardester v. Eugands, 731 S.W.2d 780 (Ark. 1987), where the Arkansas Property and Casualty Insurance Guaranty Act was applied to a claim under a fire insurance policy.

[189] IND. CODE § 27-6-8-3 (1982).

[190] IND. CODE § 27-6-8-11(a) (1982).

of remedies'' language and is thereby subject to the three-part analysis previously adduced.[191] In order for the setoff provisions to be applicable, the IIGA must demonstrate as follows: first, that the recovery resulted from a direct claim by an insured against the insured's policy, either from the standpoint of a direct payment to the insured in the first-party setting, or in the form of a tender of defense and indemnification in the third-party setting; and second, that the payment was made under an insurance policy subject to the Act, and thus arose out of a ''covered claim.''[192]

1. Third-Party Context—Tortfeasor.—In this context, the tortfeasor's carrier has become insolvent and is, thus, unable to tender a defense or indemnify the tortfeasor for any sums for which he may become liable to the injured party. Thus, the tortfeasor's claim against the guaranty association would in essence request that the IIGA stand in the shoes of the insolvent insurer, tender a defense to the tortfeasor and indemnify the tortfeasor up to the extent of the policy limits, or $49,900.00, whichever is less.[193]

Under the express setoff language in Indiana's Act, setoff vis-a-vis the tortfeasor would be limited to those situations where the tortfeasor has additional insurance which would be considered secondary insurance upon the insolvency of his primary carrier.[194] If, for example, the tortfeasor was identified as an additional insured on another policy of insurance, any defense and indemnification rights that the tortfeasor would have under that policy could be set off against the defense and indemnity obligation owed under the Act.[195]

By contrast, if a co-defendant is indemnified by a separate insurance policy which does not inure to the benefit of the tortfeasor of the insolvent carrier, any payment made on the co-defendant's behalf should not be set off against the defense and indemnity obligation that the IIGA owes to the tortfeasor of the insolvent insurer. Such a payment would inure exclusively to the benefit of the co-defendant, and would in no way discharge either the duty to defend or duty to indemnify the tortfeasor of the insolvent insurance company.

Additionally, any true excess insurance coverage which the tortfeasor of the insolvent insurer may have would not operate as a setoff against IIGA's obligations under the Act. In the situation of a true ''excess'' or ''umbrella'' policy, the insurer's duty to defend and in-

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[191]*See supra* discussion in text p. 231.

[192]Ind. Code § 27-6-8-3 (1982).

[193]*Id.* § 27-6-8-7(a)(i)-(ii).

[194]*Id.* § 27-6-8-11(a).

[195]*See, e.g.*, Ross v. Canadian Indem. Ins. Co., 142 Cal. App. 3d 396, 191 Cal. Rptr. 99 (1983).

demnify would become operative only upon the exhaustion of the underlying insurance's retained limits. Upon the insolvency of the underlying coverage, such limits would not be exhausted and an express precondition of the policy would not be met.

2. *Third-Party Context—Injured Party.*—This appears to be the most frequent area where questions arise concerning the application of the setoff clause. In this situation, an injured party is bringing a suit against a tortfeasor whose carrier has become insolvent. If a collateral source has paid part or all of the injured party's medical expenses and/or loss of income, to what extent can such payments be set off against the obligations of the IIGA under the Act?

Once again, a three-part analysis is suggested.[196] The first prong has already been answered, since we know that the injured party is pursuing a third-party claim against a tortfeasor whose liability carrier has become insolvent. Thus, in order to avail itself of the setoff provisions, the IIGA must establish initially that the payment resulted from a direct claim by the injured party as an insured under a policy of insurance.[197] Second, the IIGA must establish that the payment arose under an insurance policy which is subject to the Act, and thus was a "covered claim."[198]

Thus, any payment received by an injured party from a workmen's compensation carrier would not be available to the IIGA for purposes of setoff. Any such payment would result from the employee's claim against the employer and not as a result of any direct claim under the workmen's compensation policy.[199]

The same result, but different considerations, attach to the situation where the injured party has had part or all of his medical expenses paid by his health care provider. Any such payment would result from the injured party's status as an insured under his health care policy, and would thus satisfy the first condition of the setoff requirement. However, any such payment would arise under the injured party's health care policy, a type of direct insurance expressly excluded from coverage under the Act.[200] As such, any such payment would not be

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[196]*See supra* discussion in text p. 231.

[197]*See supra* discussion in text p. 231.

[198]IND. CODE § 27-6-8-3 (1982).

[199]*Cf. See* cases cited *supra* note 152. Senac v. Sandefer, 418 So. 2d 543 (La. 1982), in which the court used a different analysis to reach a similar conclusion. The *Senac* court concluded that a party who had received workers' compensation disability benefits would not receive a double recovery if he were permitted to recover general damages which did not include lost wages or medical expenses from the guaranty association.

[200]IND. CODE § 27-6-8-3 (1982).

a "covered claim" within the parameters of the Act, and therefore, would not be available to the IIGA for purposes of setoff.[201]

Finally, a different result is reached with respect to any payments which the injured party has received in the form of uninsured motorist benefits from his own carrier. Any such payment would result from a direct claim by the injured party against the uninsured motorist provisions in his own policy, and would thus satisfy the first part of the setoff requirement. Second, the claim would be presented under an automobile liability policy, a form of direct insurance which is not excluded from the operation of the Act. Thus, any payment received under uninsured motorist coverage would appear to be available for purposes of the Act's setoff provisions.[202]

3. *First-Party Context.*—In the first-party context, the injured party will be seeking to recover benefits which are due him as an insured under his insurance policy. Typical claims will involve uninsured motorist coverage and claims under fire policies. To the extent that the insured's carrier has become insolvent, questions of setoff may arise with respect to payments which the insured has received from collateral sources. Once again, a two-part analysis should be followed: first, whether the payment resulted from the injured party's claim as an insured under an insurance policy; and second, whether the payment resulted from a "covered claim" under the Act.

In most instances, setoff probably will not be available in the first-party context. For example, any funds which the injured party has received from the tortfeasor's carrier are not claims under a policy of direct insurance and, thus, would not be subject to the setoff provisions. Similarly, any recovery which the injured party made under his health care policy would not constitute a recovery as a result of a "covered claim" since health care policies are specifically excluded from the Act.[203]

Setoff, however, would be available in the first-party context where the injured party had secondary insurance available to him as a named

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[201]*See, e.g.*, Pritchett v. Clifton, 687 F. Supp. 644 (W.D. Mo. 1984), *aff'd*, 738 F.2d 319 (8th Cir. 1984); Harris v. Lee, 387 So. 2d 1145 (La. 1980); Bullock v. Pariser, 311 Pa. Super. 487, 457 A.2d 1287 (1983). All of these cases recognize that where a certain type of insurance is specifically excluded from the insurance guaranty association law, the setoff provisions would not be applicable to payments by such excluded insurers.

[202]For cases holding that uninsured motorist benefits received by the injured party are available to the guaranty association under similar setoff provisions, see King v. Jordan, 601 P.2d 273 (Alaska 1979); Lucas v. Illinois Guaranty Association, 52 Ill. App. 3d 237, 367 N.E.2d 469 (1977); Vokey v. Massachusetts Insurers Etc., 409 N.E.2d 783 (Mass. 1980); Prutzman v. Armstrong, 90 Wash. 2d 89, 579 P.2d 359 (1978).

[203]Ind. Code § 27-6-8-3 (1982).

or additional insured.[204] Thus, where the injured party has two separate policies under which he qualifies as an insured for purposes of uninsured motorist coverage, the IIGA should be able to set off any uninsured motorist benefits which the injured party received from the solvent insurer from the IIGA's uninsured motorist obligations on behalf of the insolvent insurer.

A similar conclusion would be reached in the context of a mortgage company which carries its own insurance on the mortgaged property, and that was also denominated as an additional insured in the standard mortgage clause under the homeowner's policy. If either the homeowner's or mortgage company's insurer became insolvent, the mortgage company would be required to exhaust its rights under the solvent carrier's policy prior to proceeding against the guaranty association. Additionally, the IIGA should be able to set off any recovery from the solvent carrier against the obligations which it owes under the Act on behalf of the insolvent insurer.[205]

4. *Setoff of Uninsured Motorist Benefits—How Much?*—A complicated issue that the Indiana courts will be required to address is what portion of a payment received under an uninsured motorist coverage will be considered a "covered claim," subject to the setoff provisions of the Act. This issue arises since uninsured motorist benefits include all elements of bodily injury damages which an injured party can recover, while Indiana's Act restricts a "covered claim" to medical expenses and lost income.[206] Theoretically, only that portion of an uninsured motorist payment which can be directly attributed to medical expenses and lost income would constitute a "covered claim" under the Act, available for setoff.

One can imagine a number of perplexing problems which the Indiana courts will be required to address in attempting to allocate a portion of an uninsured motorist payment to medical expenses and lost income (and thus a "covered claim" subject to the setoff provision) and to other elements of damage such as pain and suffering, impairment, etc. (not a "covered claim," and thus not subject to the setoff provision).[207] It is not hard to imagine the injured party taking the position that the majority of benefits paid under the uninsured motorist provisions are allocable to pain and suffering, impairment, disfigurement, etc., and the IIGA taking the position that the uninsured motorists benefits should be allocated to medical expenses and lost income.[208]

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[204]*See supra* discussion in text p. 231.

[205]*Id.*

[206]IND. CODE § 27-6-8-7(a)(i)(1) (1982).

[207]*Id.* § 27-6-8-4(4).

[208]*See supra* notes 45-52. In Rodgers v. Missouri Ins. Guar. Ass'n, 656 F. Supp. 902

Under *Kiner*, the injured party, as a precondition to recovery, will be required to demonstrate the exhaustion of remedies under other applicable insurance.[209] As such, it would appear consistent with the exhaustion of remedies provisions to allocate to the injured party the burden of proving what amount of any uninsured motorist payment is attributable to medical expenses and lost income, and what amount is attributable to such damages as pain and suffering, impairment, and disfigurement, and thus not subject to the setoff provisions.[210]

C. *"Covered Claim"*

The IIGA Act defines a "covered claim" as follows:

> The term "covered claim" means an unpaid claim or judgment which arises out of and is within the coverage and not in excess of the applicable limits of an insurance policy to which this chapter applies issued by an insurer, if the insurer becomes an insolvent insurer after the effective date (January 1, 1972) of this chapter and (a) the claimant or insured is a resident of this state at the time of the insured event or (b) the property from which the claim arises is permanently located in this state.

(E.D. Mo. 1987), the court addressed an analogous problem. The plaintiffs brought a civil rights action against a sheriff alleging a violation of the Fourth, Fifth, and Fourteenth Amendments of the United States Constitution, and 42 U.S.C. § 1983, as a result of the alleged wrongful repossession of two automobiles belonging to the plaintiffs. At the time of the incident, the defendant sheriff was insured under a liability policy issued by Ideal Mutual Insurance Company. The plaintiffs requested compensatory damages in the amount of $200,000.00, and punitive damages in the amount of $100,000.00. Following the insolvency of Ideal, the court entered a summary judgment in favor of the plaintiffs in the amount of $100,000.00. The court, however, did not specify what portion of the damages, if any, were for punitive damages. Thereafter, the plaintiffs filed proofs of claim with the Missouri Insurance Guaranty Association. The *Rodgers* court noted that the judgment represented a "covered claim" only to the extent it assessed actual damages, and that the court was thus required to segregate the judgment between actual damages and punitive damages. The court noted: "[l]acking more specific guidance, the Court will construe the judgment of the Western District to award plaintiffs actual and punitive damages in the same proportions as plaintiffs requested [in their Complaint] or in a ratio of 2:1." *Id.* at 905.

[209]Indiana Insurance Guaranty Association v. Kiner, 503 N.E.2d 923 (Ind. Ct. App. 1982).

[210]The Indiana Legislature may also wish to consider including a provision in the Act similar to that provided for in Missouri's Act. Missouri's Act contains a similar restriction to the amount of recoverable damages under a "covered claim." *See supra* note 55. The Missouri Act further provides that "verdicts as respects only those civil actions as may be brought to recover damages as provided in this subsection shall specifically set out the sums applicable to each item in this subsection for which an award may be made." Mo. Ann. Stat. § 375.785(4)(1)(a)(b) (Vernon Supp. 1987).

> "Covered claim" shall be limited as provided in section 7 [27-6-8-7] of this chapter, and shall not include (1) any amount due any reinsurer, insurer, insurance pool, or underwriting association, as subrogation recoveries or otherwise; . . . nor (2) any supplementary obligation including but not limited to adjustment fees and expenses, attorney fees and expenses, court costs, interest and bond premiums, whether arising as a policy benefit or otherwise, prior to the appointment of a liquidator; nor (3) any unpaid claim or judgment not filed timely or properly in the liquidation proceedings in accordance with the provisions of IC 27-1-4 [repealed] if the insolvent insurer is a domestic insurer or in accordance with the applicable provisions of the law of the state of domicile if the insolvent insurer is not a domestic insurer. All covered claims filed timely and properly in the liquidation proceedings shall be referred immediately to the association by the liquidator for processing as provided in this chapter.[211]

Apparently recognizing the limited applicability of the setoff provisions to payments received by an injured party from a collateral source, the courts of other jurisdictions have found creative ways to accomplish a "setoff" under statutes similar to Indiana's Act by construction of the term "unpaid claim," as well as the term "insurer subrogation."

1. Unpaid Claim or Judgment.—The IIGA Act specifically provides that a covered claim must be an "unpaid claim or judgment."[212] In construing this language, the Indiana court will likely be called upon to determine when a "claim" or "judgment" is deemed paid under the Act.

In *Florida Insurance Guaranty Association v. Dolan*,[213] a plaintiff suffered personal injuries while on the premises of the Gatlinburg Ski Corporation (GSC). Thereafter, the plaintiff sued GSC, which was defended by GSC's liability carrier. Following a $70,000.00 judgment in favor of the plaintiff, GSC's carrier was declared insolvent. In order to induce the plaintiff not to levy execution on the premises of GSC, one of GSC's operators entered into an agreement which provided for absolute, unconditional payment of the $70,000.00, being secured by a cashier's check under an escrow agreement. Thereafter, the plaintiff filed a claim against the Florida Insurance Guaranty Association.[214]

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[211] IND. CODE § 27-6-8-4(4) (1982).

[212] *Id.*

[213] 355 So. 2d 141 (Fla. Dist. Ct. App.), *cert. denied*, 361 So. 2d 831 (Fla. 1978).

[214] *Id.* at 141-42.

The Florida Act defined "covered claim" as an "unpaid claim." The *Dolan* court concluded that the plaintiff's claim was not a covered claim because the claim had been paid as a result of the unconditional guaranty of the insured's operator to satisfy the judgment, secured by a cashier's check under an escrow agreement.[215]

2. Insurer's Subrogation Claim.—Of equal importance is the Massachusetts Court of Appeals decision of *Ferrari v. Toto.*[216] In *Ferrari*, the plaintiff, while in the course of his employment was struck by an automobile negligently driven by the third-party tortfeasor, and suffered injuries. The plaintiff received over $35,000.00 in workmen's compensation benefits, and then filed suit against the tortfeasor for damages arising out of the accident. At the time of the accident, the tortfeasor carried liability insurance with per claim limits of $20,000.00. Subsequent to the filing of suit, the tortfeasor's carrier was adjudged insolvent. The Massachusetts Guaranty Association denied liability for the reason that the plaintiff had already recovered workmen's compensation benefits in excess of the limits of the tortfeasor's liability policy.[217]

The *Ferrari* court advanced two separate reasons in support of its conclusion that the plaintiff's claim was not a "covered claim" under the Massachusetts Guaranty Association Act. First, since the full extent of the Association's obligation under the Act (the $20,000.00 policy limits) had been provided by the workmen's compensation carrier, the claim had been "paid" under the Guaranty Association's Act.[218] Second, the Massachusetts Worker's Compensation Act contained a provision providing that any sum recovered by the employee in an action against a third party would be for the benefit of the workmen's compensation insurer.[219] Thus, the *Ferrari* court reasoned that the employee's claim was in reality a subrogation claim of an insurance company, which was precluded under subrogation provisions that were identical to Indiana's Act.[220]

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[215] *Id.* at 142.

[216] 9 Mass. App. Ct. 483, 402 N.E.2d 107 (1980), *aff'd*, 383 Mass. 36, 417 N.E.2d 427 (1981).

[217] *Id.* at 484-5, 402 N.E.2d at 108.

[218] *Id.* at 487, 402 N.E.2d at 109.

[219] *Id.* at 488, 402 N.E.2d at 110.

[220] Prior to the passage of the Indiana Comparative Fault Act, IND. CODE §§ 34-4-33-1 to -14 (West Supp. 1987), this type of argument could have been attacked on the basis that the insurance company's right of subrogation did not exist until the insured had been fully compensated, and that the tortfeasor's carrier's insolvency prevented complete compensation. *See, e.g.*, Willard v. Auto. Underwriters, Inc., 407 N.E.2d 1192 (Ind. Ct. App. 1980); Capps v. Klebs, 178 Ind. App. 293, 382 N.E.2d 947 (1979). The continuing validity of the rule against "pro tanto subrogation" may be brought into question under

A different conclusion was reached by the New Jersey Superior Court under similar circumstances in the decision of *Arnone v. Murphy*.[221] In *Arnone*, the insured had received workmen's compensation benefits, and subsequently sued the tortfeasor. When the tortfeasor's insurer became insolvent, a claim was filed with the New Jersey Guaranty Association.[222]

The court concluded that the guaranty association was liable to the claimant even though the insurance proceeds were subject to the lien of a workmen's compensation carrier. The *Arnone* court reasoned that the claim was that of the injured party, not that of the insurer. Although the term "covered claim" in the New Jersey statute excluded any claim of an insurer, the court reasoned that the workmen's compensation carrier's interest was a "lien," rather than a "claim." The court further noted that since workmen's compensation was expressly exempted from the New Jersey Guaranty Association Act, the payment to the employee would not "result in the shuffling of funds among member insurers."[223]

To the extent that the distinction between the principles advanced in *Ferrari* and *Arnone* is a logical one vis-a-vis the capacity in which the injured party is pursuing recovery of a claim against the guaranty association, considerable problems arise in applying the rationale advanced to a claimant under the Indiana Act who has received workmen's compensation benefits. On one hand, if the claimant has received

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the provisions of Indiana Code sections 34-4-33-12, and -14. Indiana Code section 34-4-33-12 (Supp. 1987) provides:

> If a subrogation claim or other lien or claim, other than a lien under I.C. 22-3-2-13 or I.C. 22-3-7-36, that arose out of the payment of medical expenses or other benefits exists in respect to a claim for personal injuries or death and the claimant's recovery is diminished:
>
> (1) by comparative fault; or
>
> (2) by reason of the uncollectability of the full value of the claim for personal injuries or death resulting from limited liability insurance or from any other cause
>
> the lien or claim shall be diminished in the same proportion as the claimant's recovery is diminished.

IND. CODE § 34-4-33-12 (Supp. 1987). IND. CODE § 34-4-33-14 (Supp. 1987), on the other hand, provides:

> In any action tried under this chapter, any subrogation or lien for collateral benefits received by the prevailing party shall be reduced by the ratio of the lower of the prevailing party's judgment or collected judgment to the amount of damages the trier of fact found the prevailing party to have sustained.

Id.

[221] 153 N.J. Super. 584, 380 A.2d 734 (1977).

[222] *Id.* at 588-89, 380 A.2d at 736-37.

[223] *Id.* at 594, 380 A.2d at 739.

workmen's compensation benefits and then obtains a settlement or judgment against the tortfeasor, Indiana Code section 22-3-2-13 provides that "from the amount received by the employee . . . there shall be paid to the employer or the employer's compensation insurance carrier, . . . the amount of compensation paid to the employee . . . plus medical, surgical, hospital . . . ." Since workmen's compensation insurance is covered by the Act, this would result in the shuffling of funds among "member insurers."[224]

The same provision of the Indiana Workmen's Compensation Act also provides that "the employer's compensation insurance carrier shall have a lien upon any settlement award, judgment, or fund out of which the employee might be compensated from the third party."[225] It will be left to the Indiana courts to address these provisions of the Indiana Workmen's Compensation Act, vis-a-vis the subrogation provisions of the IIGA Act and the rationale of *Ferrari* and *Arnone*.

The same type of issue may arise with respect to language in many health care policies, providing that to the extent of payment under the policy, the insurer is subrogated to all rights of recovery against the alleged tortfeasor.[226] If the Indiana courts adopt the reasoning of *Ferrari* that the "real party" pursing the claim is the insurance company, any recovery could be precluded under the Act's prohibition against insurer recovery from the guaranty fund.[227] If, on the other hand, the Indiana courts adopt the reasoning of *Arnone*, recovery under the Act would

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[224]IND. CODE § 22-3-2-13 (1981). Both the insolvent liability carrier of the tortfeasor and the workmen's compensation carrier would be member insurers under the Act. IND. CODE § 27-6-8-4(6) (1982).

[225]IND. CODE § 22-3-2-13 (1982).

[226]For example, in Mutual Hosp. Ins., Inc. v. MacGregor, 174 Ind. App. 550, 368 N.E.2d 1376 (1977), the following provision of a Blue Cross-Blue Shield policy was at issue:

> In the event of any payment for services under this Policy, Blue Cross-Blue Shield shall, to the extent of such payment, be subrogated to all the rights of recovery of the Member or Dependent arising out of any claim or cause of action which may accrue because of the alleged negligent conduct of a third party. Any such Member or Dependent hereby agrees to reimburse Blue Cross-Blue Shield, for any benefits so paid hereunder, out of any monies recovered from such third party as the result of judgment, settlement or otherwise; and such Member or Dependent hereby agrees to take such action, to furnish such information and assistance, and to execute and deliver all necessary instruments as Blue Cross-Blue Shield may require to facilitate the enforcement of their rights. This provision shall not apply, however, to a recovery obtained by a Member or Dependent from any insurance company on a policy under which said Member or Dependent is entitled to indemnity as a named insured person.

Id. at 1377.

[227]IND. CODE § 27-6-8-4(4) (1982).

not be precluded, since any payment to the injured party would not inure to the benefit of a member insurer.

D. Subrogation of IIGA

One important point must be made with respect to a first-party claim against the IIGA as a result of the insured's carrier becoming insolvent. In this context, the insured is pursuing a direct claim against the IIGA, who is standing in the shoes of the insured's insolvent carrier. The insured is bound by all terms and conditions of the original insurance policy,[228] including the duty to cooperate, and the subrogation and "hold in trust" provisions of the policy. In fact, the Indiana Act expressly provides that any party receiving payment shall be deemed to have assigned his rights under the policy to IIGA, to the extent of payment by the IIGA.[229]

As such, special care should be given to any settlement with a tortfeasor or his insurance carrier so as not to impair IIGA's subrogation rights. There is a substantial body of case law in Indiana indicating that the insured's general release of a tortfeasor will destroy the insurance company's subrogation rights and preclude the insured from making any claim under the insurance policy.[230] This type of reasoning could be equally applicable to deny an injured party access to the IIGA if he has destroyed IIGA's subrogation rights via a general release of the tortfeasor.[231]

E. IIGA's Duty to Defend

Some interesting case law has developed in other jurisdictions in the third-party context concerning IIGA's duty to defend the tortfeasor of the insolvent insurer.

1. Pre-Insolvency Attorney Fees.—The Act specifically provides that a "covered claim" does not include "attorney's fees and expenses, court costs, interest, bond premiums, whether arising as a policy benefit

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[228]*See* Pannell v. Missouri Ins. Guar. Ass'n, 595 S.W.2d 339 (Mo. Ct. App. 1980) (insured is required to comply with conditions of policy of insolvent insurer).

[229]Ind. Code § 27-6-8-10(a) (1982).

[230]*See, e.g.*, Allstate Ins. Co. v. Meek, 489 N.E.2d 530 (Ind. Ct. App. 1986); Dravet v. Vernon Fire & Casualty Ins. Co., 454 N.E.2d 440 (Ind. Ct. App. 1983); Hockelberg v. Farm Bureau Ins. Co., 407 N.E.2d 1160 (Ind. Ct. App. 1980). *But see* National Mut. Ins. Co., 454 N.E.2d 1386 (Ind. Ct. App. 1981).

[231]*See, e.g.*, Hemisphere Nat. Bank v. District of Columbia, 412 A.2d 31 (D.C. App. 1980) (if the claimant takes actions which prejudice subrogation rights to which the guaranty association would be entitled, the claimant is barred to the extent that the guaranty association rights were prejudiced).

or otherwise, prior to the appointment of a liquidator."[232] Similar provisions have been construed by the courts of other jurisdictions to indicate that a guaranty association was not obligated to pay attorney fees incurred by the insurer in tendering a defense to the insured tortfeasor before the carrier became insolvent.[233] Thus, a law firm which has undertaken the defense of an insured at the request of a carrier who becomes insolvent cannot recover pre-insolvency attorney fees from the guaranty association. Rather, its sole remedy is to file a claim with the liquidator.[234]

2. *Bad Faith.*—Numerous decisions from other jurisdictions have addressed the issue of whether a guaranty association can be held liable for the insolvent insurer's bad faith refusal to settle a claim within policy limits prior to insolvency. The courts have uniformly concluded that the guaranty association was not vicariously liable for its members' torts.[235]

Additionally, cases have also addressed the issue of whether the guaranty association can be held liable on a bad faith basis for itself refusing to accept an offer to settle a personal injury claim within the limits of the policy of an insolvent insurer. The courts have likewise concluded that no bad faith action can be maintained against the guaranty association for a failure to settle within policy limits.[236]

3. *Breach of Duty to Defend.*—One additional decision merits review concerning the guaranty association's duty to defend. In *Carrousel Concessions, Inc. v. Florida Insurance Guaranty Association*,[237] the insured tortfeasor brought an action against the guaranty association claiming that an inadequate defense had been provided. The Florida Court of Appeals agreed with the insured's contentions, and determined that the guaranty association was obligated to provide an "adequate defense." The court further held that if an inadequate defense was provided, the guaranty association could be sued for a breach of the

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[232] IND. CODE § 27-6-8-4(4) (1982).

[233] *See, e.g.*, Maguire, Ward, Maguire & Eldredge v. Idaho Ins. Guar. Ass'n, 112 Idaho 166, 730 P.2d 1086 (Idaho Ct. App. 1986); Metry, Metry, Sanom and Ashare v. Michigan Prop. & Cas. Guar. Ass'n, 403 Mich. 117, 267 N.W.2d 695 (1978); Ohio Ins. Guar. Ass'n v. Simpson, 1 Ohio App. 3d. 112, 439 N.E.2d 1257 (1981); Greenfield v. Pennsylvania Ins. Guar. Ass'n, 256 Pa. Super. 136, 389 A.2d 638 (1978).

[234] *See* IND. CODE § 27-9-1-1 to -4-10 (1982).

[235] *See, e.g.*, Rivera v. South Am. Fire Ins. Co., 361 So. 2d 193, (Fla. Ct. App. 1978), *cert. denied*, 368 So. 2d 1372 (Fla. 1979); Vaughn v. Vaughn, 23 Wash. App. 527, 597 P.2d 932 (1979).

[236] *See, e.g.*, Interstate Fire & Cas. Ins. Co. v. California Ins. Guar. Ass'n, 125 Cal. App. 3d 904, 178 Cal. Rptr. 673 (1981); Fernandez v. Florida Ins. Guar. Ass'n, 383 So. 2d 974 (Fla. Ct. App.), 389 So. 2d. 1109 (Fla. 1980).

[237] 483 So. 2d 513 (Fla. App. 1986).

duty to defend the insured. Under such circumstances, the injured insured may be entitled to recover attorney fees and costs if he can establish that the defense supplied by the guaranty association was inadequate, and that it was reasonable for the insured to engage his own attorney in order to provide a defense to the action.[238]

V. Conclusion

The stated purpose of the Indiana Guaranty Association Act is, *inter alia*, "to avoid excessive financial loss to claimants or policyholders because of the insolvency of an insurer."[239] Despite the stated purpose, the Indiana Legislature has enacted one of the most restrictive property/casualty guaranty association acts in the country, joining Colorado as the only two jurisdictions limiting per claim liability to $49,400.00.[240] Additionally, Indiana is one of only four jurisdictions which limit an injured party's recovery under the Guaranty Association Act to essentially medical expenses and lost wages, thereby precluding, by legislative fiat, an injured party's ability to recover common law damages for pain and suffering, disfigurement and/or deformity, etc.[241]

The Indiana Guaranty Association Act has remained relatively unchanged since its passage in 1971. During the recent sunset audit of the Indiana Department of Insurance, the legislature addressed, *inter alia*, the current state of affairs of the Indiana Guaranty Association.[242] It is hoped that the Indiana Legislature will follow the lead of other jurisdictions which have recognized that soaring medical costs will require a reassessment of the per claim/per occurrence limits of liability currently provided for in the Indiana Act. It is further hoped that the Indiana Legislature will consider and address the inherent conflicts which currently exist between the Indiana Guaranty Association Act, and other acts which are subject to its jurisdiction, such as the Indiana Workmen's Compensation Act, and the Indiana Medical Malpractice Act.

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[238] *Id.* at 517.
[239] Ind. Code § 27-6-8-2 (1982).
[240] *See supra* note 30.
[241] *See supra* notes 53-56 and accompanying text.
[242] Indiana Underwriter (October 1987), p.1.

The Indiana Judicial System: An Analysis of Change

John L. Kellam*

I. Introduction

For several years Indiana judges, legislators, local government officials, and lawyers have recognized that our trial court system needs reform. In 1975 the Indiana Judges Association also perceived this need and began a study of the state's trial court system. In 1978 the Association published a two-volume report[1] and submitted it to the General Assembly. In the report, the Association recommended that "[t]he Indiana trial courts should be organized on the basis of a unified state wide trial court system."[2] The Association also made general recommendations concerning the then existing trial court system[3] and, with substantial assistance from the Indiana Council of Juvenile Court Judges, submitted recommendations concerning the juvenile court system.[4]

The proposed unified system would consist of a single tier of trial courts each of which has the same subject matter jurisdiction.[5] The trial courts would be organized into geographic districts with a presiding judge in each district exercising general supervisory authority over the courts in the district.[6] The trial courts would "be funded by the state under the budgetary authority of the Chief Justice of the Supreme Court."[7]

Although the legislature did not act on the report immediately and has not implemented a unified court system, both the legislature and the courts have subsequently implemented some of the general proposals.[8] Nevertheless, the need for comprehensive administrative and organizational reform of the trial court system remained.

In 1986, the Legislative Council of the General Assembly created an Interim Committee on Courts and Civil Procedure. The Committee's assignment was to review the Indiana court system and consider a

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[1]Indiana Judges Association, The Indiana Trial Court System Recommended Improvements (1978) [hereinafter 1978 Proposal].

[2]1978 Proposal, *supra* note 1, at 15.

[3]*Id.* at 71-80.

[4]*Id.* at 81-148.

[5]*Id.* at 15.

[6]*Id.*

[7]*Id.* at 16.

[8]*See* Indiana Judges Association, A Proposal for Reform of the Indiana Trial Court System 3-8 (1986) [hereinafter 1986 Proposal].

comprehensive plan to improve it. The Association prepared a second proposal.[9] After receiving comments from judges and an analysis of the proposal from a committee of the state bar association, the Judges Association modified the report by adding an addendum. The Association then submitted the modified proposal to the Interim Committee, but, due to time constraints, the Committee was unable to adequately study the proposal.

In 1987 the General Assembly created a commission to study the needs and problems of the state's trial courts, conduct public hearings throughout the state, analyze financial mechanisms to implement a reform plan, and report to the General Assembly before October 1, 1988.[10]

This article will review some of the organizational and administrative problems that now exist in the trial court system as well as some of the other issues that are important to judges, local government officials, lawyers, and citizens and that ought to be considered in any truly comprehensive reform plan. This article will also discuss the Indiana Judges Association's proposals as well as some of the criticisms of those proposals.

II. Administrative, Structural, and Fiscal Reform: A Unified Trial Court System

A. *Indiana's Trial Court System*

The state constitution provides for "one Supreme Court, one Court of Appeals, Circuit Courts, and such other courts as the General Assembly may establish."[11] Although the constitution limits the legislature's power respecting the structure and jurisdiction of the supreme court[12] and the court of appeals,[13] it gives the legislature broad authority respecting the structure and jurisdiction of the circuit courts and other courts the legislature may establish.[14] Over the years, the legislature has created and abolished courts in response to specific perceived needs. Thus, the state trial court system has evolved sporadically, and, consequently, the state's trial court system is not the epitome of planning and structure. Instead, Indiana has a sometimes confusing combination of circuit courts,

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[9]*Id.*

[10]Act approved May 6, 1987, Senate Enrolled Act 18, sec. 4, 6 West's Ind. Legis. Serv. 81, 82-84. Senator Edward A. Pease is the chairman, and Representative John W. Donaldson is vice-chairman.

[11]Ind. Const. art. VII, § 1.

[12]*Id.* art. VII, §§ 2, 4.

[13]*Id.* art. VII, §§ 5, 6.

[14]*Id.* art. VII, §§ 7, 8.

superior courts, county courts, municipal courts, small claim courts, one probate court, and city and town courts.

The state now has ninety circuit courts.[15] Eighty-eight of Indiana's ninety-two counties have a circuit court; the remaining four counties are in joint circuits of two counties each.[16] Each circuit court "has original jurisdiction in all civil cases and in all criminal cases, except where exclusive jurisdiction is conferred by law upon other courts of the same territorial jurisdiction."[17] To determine the extent of a particular circuit court's jurisdiction, one must determine whether the legislature has granted exclusive jurisdiction over certain matters to another court within the circuit's boundary. Consequently, the original jurisdiction of the various circuit courts varies from circuit to circuit.[18]

Effective January 1, 1988, there will be more than 130 superior court judges in fifty-five counties.[19] Some counties, for example, LaPorte and Tippecanoe, have more than one superior court.[20] On the other hand, one superior court serves both Ohio and Switzerland Counties.[21] Some of the larger counties have a unified superior court but have more than one superior court judge.[22] Generally, the jurisdiction of the superior courts is coextensive with that of the circuit courts; however, specific statutes prescribe the subject matter jurisdiction of a particular superior court. Frequently, certain matters will be reserved exclusively for the circuit court or for the superior court or for a particular superior court if there is more than one superior court sharing authority with a circuit court.

The only court that is called a probate court is in St. Joseph County.[23] It has concurrent jurisdiction with the county superior court over such matters as the probate of wills, guardianships, and administration of trusts.[24] It also has exclusive juvenile jurisdiction in the county.[25]

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[15]Ind. Code §§33-4-1-1 to -92 (1982 & Supp. 1987).

[16]*Id.* §§ 33-4-1-39, -78 (Jefferson and Switzerland Counties) and §§ 33-4-1-15, -58 (Dearborn and Ohio Counties).

[17]*Id.* § 33-4-4-3(a) (Supp. 1987).

[18]For example, the Allen Circuit Court does not have juvenile jurisdiction because the Allen Superior Court has exclusive juvenile jurisdiction. *Id.* § 33-5-5.1-5. In Boone County the circuit court has exclusive juvenile jurisdiction and Superior Court no. 1 has exclusive probate jurisdiction. *Id.* § 33-5-9-5.

[19]*Id.* §§ 33-5-4.5-1 to -50-1.

[20]*See id.* §§ 33-5-31.1-1, -41-1, -42.1-1.

[21]*Id.* § 33-5-37.7-2.

[22]*See id.* § 33-5-35.1-1 (Marion County).

[23]*Id.* §§ 33-8-2-1 to -24.

[24]*Id.* § 33-8-2-9.

[25]*Id.* § 33-8-2-10.

Effective January 1, 1976, the General Assembly established a county court system.[26] Since then the legislature has upgraded some of these county courts to superior courts, but several counties still have a county court.[27] County courts have limited jurisdiction in both civil and criminal matters. They have original concurrent jurisdiction over actions in contract or tort in which the amount claimed is not more than $10,000[28] and in possessory actions between landlord and tenant.[29] County courts have "original exclusive jurisdiction in actions for the possession of property where the value of the property sought to be recovered does not exceed ten thousand dollars."[30] County courts have no jurisdiction to issue injunctions, to appoint receivers, or to hear cases "pertaining to paternity, juvenile or probate . . . or in suits for dissolution of marriage."[31] County courts may hold "preliminary hearings in felony cases."[32] In addition, the county courts have original and concurrent jurisdiction over "all Class D felony, misdemeanor, and infraction cases"[33] and ordinance violations.[34]

Marion County has no county courts, but it has municipal[35] and small claims courts.[36] The municipal courts have concurrent, original jurisdiction in tort and contract actions where the claim does not exceed $20,000.[37] They also have jurisdiction in possessory actions between landlord and tenant.[38] The municipal courts have jurisdiction over ordinance violations,[39] misdemeanors and infractions,[40] and Class D felonies.[41] Municipal courts may issue warrants and conduct certain pretrial hearings in criminal cases,[42] and they have jurisdiction over some

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[26] *Id.* § 33-10.5-1-1.

[27] *Id.* § 33-10.5-1-4(a). That section provides:

A county court is established in each county, except a county:

(1) for which [§ 33-10.5-1-5] provides a joint county court;

(2) for which IC 33-4 provides a small claims docket of the circuit court;

(3) for which IC 33-5 provides a small claims docket of the superior court; or

(4) for which IC 33-11.6 provides a small claims court.

[28] *Id.* § 33-10.5-3-1.

[29] *Id.*

[30] *Id.*

[31] *Id.* § 33-10.5-3-2.

[32] *Id.*

[33] *Id.* § 33-10.5-3-1(a)(3).

[34] *Id.* §§ 33-10.5-3-1(a)(4), -1(a)(5).

[35] *Id.* §§ 33-6-1-1 to -9-5.

[36] *Id.* §§ 33-11.6-1-1 to -30.

[37] *Id.* § 33-6-1-2(a)(1).

[38] *Id.* § 33-6-1-2(a)(2).

[39] *Id.* § 33-6-1-2(a)(3), -2(a)(5).

[40] *Id.* § 33-1-6-2(a)(4).

[41] *Id.* § 33-6-1-2(a)(7).

[42] *Id.* § 33-6-1-2(a)(6).

guardianship proceedings.[43] The municipal courts have no jurisdiction in actions involving title to real estate, appointment of a receiver, or dissolution of marriage.[44]

The small claims courts have concurrent original jurisdiction over tort or contract cases where the amount claimed is not more than $3000,[45] over possessory actions where the amount or value claimed is not more than $3000,[46] and over petitions for certain protective orders.[47] Small claims courts have no jurisdiction to grant injunctions, partition real property, declare or enforce liens, appoint a receiver, or dissolve a marriage.[48]

Finally, the legislature has authorized second- and third-class cities and towns to establish city or town courts.[49] These courts have jurisdiction over ordinance violations, misdemeanors, and infractions.[50] City courts also have jurisdiction over some civil matters, the limits of which depend upon the size of the city.[51]

Some of these trial courts also have appellate jurisdiction. Appeals from a city court are tried de novo in the circuit or superior court.[52] Similarly, appeals from the Marion County Small Claims Court are tried de novo in municipal court.[53]

B. *Some Organizational and Administrative Problems with the Present Trial Court System*

1. *Uneven Distribution of Work Loads Among the Courts.*—The legislature has directed the Division of State Court Administration to collect and compile data on the judicial work of the state's courts and on revenues generated and funds spent by the courts.[54] This data shows that from 1977 to 1986 court filings increased from 751,989 cases filed in 231 courts to 1,072,315 cases in 269 courts.[55] Thus, filings increased forty-three percent during that ten-year period, but the number of courts

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[43] *Id.* § 33-6-1-2(a)(8).
[44] *Id.* § 33-6-1-2(b).
[45] *Id.* § 33-11.6-4-2.
[46] *Id.* § 33-11.6-4-3.
[47] *Id.* § 33-11.6-4-4.
[48] *Id.*
[49] *Id.* § 33-10.1-1-3.
[50] *Id.* §§ 33-10.1-2-2, -7. A town court has *exclusive* jurisdiction over violations of town ordinances. *Id.* § 33-10.1-2-7(a).
[51] *Id.* §§ 33-10.1-2-3.1, -4, -5.
[52] *Id.* § 33-10.1-5-9(a).
[53] *Id.* § 33-11.6-4-14.
[54] *Id.* § 33-2.1-7-3.
[55] DIVISION OF STATE COURT ADMINISTRATION 1986 INDIANA JUDICIAL REPORT 40-41 [hereinafter 1986 JUDICIAL REPORT].

handling this increased work load increased only sixteen percent. Even so, this data does not tell the whole story. Each case, whether it is a traffic citation or a capital murder case, is simply shown as one case. The actual amount of judicial time and resources needed to handle these cases is quite different. Thus, the data does not adequately describe the "work load" of a given court.

Indiana's trial courts have managed to meet these increased demands. It has not been easy for many of the trial courts to keep up with the increasing work load, and the existing organization makes it more difficult to do so. Because jurisdictional authority is not uniform among the various courts within a circuit, it is not always possible to transfer cases from one court to another in order to alleviate backlogs. Thus, even if a nearby court has the time and resources to take on additional cases, it often cannot do so simply because it does not have proper subject matter jurisdiction. In addition, filings vary widely from county to county. For example, in 1986 while the Lake County Circuit Court handled 10,901 new filings,[56] most of the circuit courts handled less than 1000 new filings.[57] Under the present system there simply is not an effective and efficient way to equalize work loads among the various courts.

2. *Funding Problems.*—The legislature has always maintained structural and substantive control over Indiana's judiciary and has decided that local units of government should fund the courts. The net result of this decision has been to relegate the judiciary to a position of competing with departments of local government for limited local funds while the courts attempt to comply with legislative and appellate court mandates. To make matters worse the legislature has restrained local government's ability to obtain revenues. Since 1973 tax levies have been frozen, and, more recently, federal and state funds have been withdrawn. As a result, the ability of the counties to continue funding the state's judiciary is in jeopardy. Where adequate funds are not available, courts are understaffed, the staff is underpaid, and both the staff and the judges must work with inadequate equipment and facilities. The quality of justice a county's citizens receive is not always directly proportional to the competence of the judge and the judge's staff. Sadly, the quality of justice often depends upon the county's tax base.

Real property taxes are the major source of local government revenue. Thus, even though the courts are open to all citizens, this method of funding disproportionately burdens the real property owners. On the other hand, most of the state government's revenues come from more broad-based sources: income and sales taxes.

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[56]*Id.* at 114-15.
[57]*Id.* at 102-33.

Futhermore, the state enjoys a net income from the state's courts while the counties suffer a net loss. In fiscal year 1977-78 the state spent $9.2 million on the judiciary and received revenues of $13.9 million.[58] Thus, the state enjoyed a net income from the courts of $4.7 million. During the same period, counties spent $24.9 million and received only $7.3 million[59]—a net loss of $17.6 million. In fiscal year 1985-86 the state's net revenues from the courts increased to $9.5 million,[60] and the net expense to the counties increased to $32.5 million.[61] Although the legislature has redefined and redistributed court costs,[62] the state will still derive a profit from the courts while the counties will continue to bear the expense burden.

C. *The Judges Association Proposal*

The core concept of the Association Proposal is a state funded unified trial court system. The proposal also deals with other problems in Indiana's trial court system. Because some of the suggestions involve "procedural" issues and other involve "substantive" issues, the Association suggests that clearly substantive issues be presented to the General Assembly and clearly procedural ones be submitted to the supreme court. In order to avoid separation of powers problems, the Association is also recommending that all aspects of the proposed unified court system be enacted by the General Assembly and adopted by the Indiana Supreme Court.[63] In the same vein, the Association suggests that a permanent commission to review, assess, and make recommendations relating to procedural and substantive differences be formed.[64]

1. *A Unified Trial Court System.*—The Indiana Judges Association is proposing a uniform trial court system.[65] Each of the trial courts in the uniform system would have the same subject matter jurisdiction.[66] The General Assembly would continue to establish circuit courts, but the state would be divided into fifteen geographic districts.[67] The districts

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[58]*Id.* at 214-15.

[59]*Id.* This does not include revenues from city, town, and small claims courts. *Id.*

[60]*Id.*

[61]*Id.*

[62]Act approved May 6, 1987, Pub. L. 305-1987 (House Enrolled Act 1163), 6 West's 1987 Indiana Legis. Serv. 758.

[63]1986 PROPOSAL, *supra* note 8, at 24.

[64]*Id.*

[65]*Id.*

[66]*Id.* at 10. Initially the Marion County small claims courts and the city and town courts would remain in existence after the unified system is established. *Id.* at 17.

[67]*Id.* at A-7 to A-8. There are now 14 districts. ADMIN. R. OF CT. 3, *reprinted in* West's Annotated Indiana Code tit. 34 app. at 423-24. The Association proposes that Marion County should constitute the fifteenth district.

would have an administrative function, and a presiding judge would serve as the district's administrative supervisor.[68]

The presiding judge would have general supervisory authority subject to the final supervisory authority of the Chief Justice.[69] The presiding judge would have the authority to: (1) assign judges and non-confidential court personnel with the district, (2) supervise the district's financial affairs, (3) supervise a program of continuing education for the district's judges and court personnel, (4) serve as the district's chief representative, and (5) supervise the work of the district's administrative staff.[70]

Because each of the courts in the district would have equal subject matter jurisdiction, the presiding judge would be able to equalize work loads among the various courts in the district by transferring cases from courts with crowded dockets to courts with less crowded dockets, or the presiding judge may transfer a judge to aid another judge with an overloaded docket. The unified system will allow each judge to operate with utmost efficiency and not be hampered by a limitation on the court's authority to exercise jurisdiction.

Some judges might complain that because they sought and were elected to a particular court, the proposed system, if adopted, would require them to hear matters they never intended to hear when they sought election to the court. Even if that is true, no judge has a vested right to have authority over a particular range of subject matters. In addition, that a judge has authority to hear a wide range of cases does not necessarily mean that the judge will fully exercise that authority. The unified system *permits* each judge this full authority; it does not necessarily require that each judge exercise it. Many of the larger trial court systems within the state have developed certain areas of specialization. That specialization need not necessarily change when a unified system is put in place.

Some trial judges have expressed concern that there would not be enough local input in the process of determining how the local courts will function. Responding to this concern, the association added a proposal that the Indiana Supreme Court require each circuit to submit a circuit plan.[71] The circuit plan, which would be submitted to the presiding judge,[72] would include:

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[68] 1986 PROPOSAL, *supra* note 8, at 10-11.

[69] *Id.* at 13.

[70] *Id.* The Association recommends that a trial judge be permitted to appeal the presiding judge's decision, but that the presiding judge's decision could be reversed only for an abuse of discretion. *Id.*

[71] *Id.* at A-8.

[72] *Id.* at A-9.

(a) An assessment of the various workloads of judges within the circuit;
(b) The necessity for transfer of cases to initially equalize workloads within the circuit;
(c) Consideration of the necessity or lack of necessity for a mandatory rotating filing system within the circuit;
(d) An assessment of the need or lack of need for additional judges to assist in the handling of caseloads within a circuit;
(e) The adequacy of probation services within the circuit, including the existence of any court-related programs and facilities;
(f) The need or lack of need to maintain existing court-related programs and facilities;
(g) The need or lack of need for the existence of specialized divisions of the district court within a circuit;
(h) If there exists a need for specialized divisions of the district court within a circuit, the proposed manner of rotation or non-rotation of judges in those divisions;
(i) The allocation of court personnel within the circuit;
(j) The adequacy of law libraries within the circuit;
(k) The availability of "senior judges" within the circuit;
(l) Provision of legal services for indigents in criminal cases;
(m) Any other matters which the Indiana Supreme Court deems necessary to acquire input from trial judges and to assess existing situations within the various circuits.[73]

The presiding judge would then file a district plan with the supreme court.[74] The content of the district plan parallels the circuit plan.[75] In addition, the presiding judge must file "[a] statement as to the means by which information will be gathered and workloads of the various district judges will be assessed"[76] and "[a] statement of the guidelines to be utilized by the presiding judge in the transfer of cases or judges within the district when such is necessary to equalize workloads."[77] The supreme court may "approve, disapprove, or modify the plan as it deems necessary."[78]

The preparation and submission of budgets for the unified court system would follow a similar procedure.[79]

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[73]*Id.* at A-8 to A-9.
[74]*Id.* at A-9 to A-11.
[75]*Id.*
[76]*Id.* at A-11.
[77]*Id.*
[78]*Id.*
[79]*Id.* at A-11 to A-13.

2. *State Funding.*—The Judges Association believes that the judiciary is, and should be, a third branch of the state government and that a court's ability to serve the citizens of a particular county should not depend upon that county's resources or upon the court's ability to obtain its share of limited local funds. Thus, the Association is proposing that the state should assume the cost of operating the court system.[80]

The revenues the courts generate through costs and fees have been less than the costs of operating the court system. It is assumed that this will continue to be true in the future. In 1986, for example, the state and counties spent $72.9 million to operate the judicial system, and court revenues to the state and counties totaled $49.9 million.[81] Thus, expenses exceeded revenues by $23 million. The Association is proposing that all revenues generated by the courts, except those used only for local programs, be forwarded to the state.[82]

The Association recognizes, however, that the state cannot and should not be responsible for maintaining court facilities. For the most part, the courts share facilities with other departments of local government. Thus, it seems only practical that the counties retain the obligation to provide facilities for the courts. The Association is also aware that the fiscal impact on the state should be a major consideration. In 1986, to operate, the courts, local and state governments had a combined net operating expense of $21.7 million.[83] That same year, the state received a net income of $9.5 million.[84] Using these 1986 figures, the state will have additional expenses of $31.2 million. Because of public law 305-1987[85] it is difficult to project the actual fiscal impact that state funding will have on the state; however, expenses are certain to climb because judges' salaries increased effective July 1, 1987.[86]

Other states that have switched or are switching to state funding have implemented the funding over a number of years. This procedure alleviates the adverse repercussions of an immediate and total transfer to state funding. The Association's proposal likewise seeks to alleviate such problems. Under the proposal, local units of government will maintain court facilities. Each county will be assessed a per capita sum for operating the courts, and each county will receive a credit against

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[80]*Id.* at 25-31.

[81]1986 Judicial Report, *supra* note 55, at 214-15. These figures do not include city, town, or township expenditures or revenues. *Id.*

[82]1986 Proposal, *supra* note 8, at 25-31, A-1 to A-2.

[83]1986 Judicial Report, *supra* note 55, at 214-15.

[84]*Id.*

[85]Act approved May 6, 1987, Pub. L. 305-1987 (House Enrolled Act 1163), 6 West's 1987 Indiana Legis. Serv. 758.

[86]Ind. Code §§ 33-13-12-7 to -9 (Supp. 1987).

that assessment up to a percentage established by the legislature. Either or both the assessment or the credit can be adjusted to permit the state to receive relatively more funds from local units of government in the beginning years of the transition and relatively less funds in successive years. This accomplishes the same purpose of alleviating the initial fiscal impact on the state while also assuring that local governments will continue to maintain court facilities.

State funding of a unified system would result in a lesser degree of control over the judiciary by local units of government. Such control, to the extent it now exists, is founded solely upon legislative enactment. The Indiana Constitution does not require or expressly provide for local control of the courts. Because of the adverse effect that the present method of funding the state's courts has on local governments, they may welcome a switch to state funding even if that means they will lose some control over the judiciary.

III. Change of Judge and Change of Venue

The controversy surrounding change of judge and change of venue has existed among judges, attorneys, and legislators for a number of years. Prior to 1981, Criminal Rule 12 provided for a mandatory change of judge in all criminal cases upon the filing of a timely motion. In 1981, the General Assembly enacted a statute that restricted change of judge in criminal cases.[87] That statute specifies the causes for which the defendant or the state may seek a change of judge and specifies that a motion for change of judge must state facts that show at least one of these causes. The Indiana Supreme Court, discerning what it determined to be legislative intent, amended Criminal Rule 12 to require a showing of cause as provided in that statute. The court also made the effective date of the amended rule coincide with the statute's July 1, 1981, effective date.

In 1982, the General Assembly stated, in a preamble to related legislation, that it was not intended that the statute change the law.[88] In *Hobbs v. State*,[89] the Indiana Court of Appeals held that the preamble did not serve to reinstate the automatic change of judge in criminal cases.[90]

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[87]*Id.* § 35-36-5-2 (1982).

[88]*See* Act approved February 25, 1982, Pub. L. 204, 1982 Ind. Acts 1518. The preamble to that Act states: "IC 35-36-5 shall not be construed to have changed the prior law of Indiana concerning change of judge, specifically the rule of law permitting automatic change of judge upon request."

[89]451 N.E.2d 356 (Ind. Ct. App. 1983).

[90]*Id.*

In 1984, the General Assembly amended section 35-36-5-1 to provide a "substantive right" for an automatic change of judge in criminal cases.[91] The Indiana Supreme Court then held that the statute conflicted with Criminal Rule 12, that the matter was "procedural," that Criminal Rule 12 controlled and that the amended statute was of no force and effect to the extent it conflicted with Criminal Rule 12.[92] During this period, the right to a mandatory change of judge or change of venue in civil proceedings has remained intact.[93]

The legislature and the supreme court each perceive that the other is infringing upon its power inherent in the separation of powers doctrine in the constitution. Attorneys sense a legitimate need for an automatic change of venue and change of judge in order to protect their clients from a judge's prejudice or bias or to avoid the harmful effects of a personality conflict between the attorney and the judge. Attorneys believe that they should not be required to introduce evidence of the judge's bias or prejudice in order to obtain a change of judge. In highly publicized cases the attorneys may have legitimate concerns that a change of venue to another county is necessary in order to obtain a fair trial. Conversely, an automatic change rule permits delay, and, where the rule allows counsel to agree to the judge or the court of venue, it permits "forum shopping." This shopping for judges and forums has created some of the major inequities in our existing court system.

The Association's original proposal retained the right of automatic change of venue and change of judge, but it permitted the presiding judge to select the panels of counties or judges.[94] This would allow the presiding judge to maintain equalization of work loads among the courts in the district. The proposal eliminates forum and judge shopping by making no provision for agreement by attorneys. Attorneys objected to this proposal because they wanted to retain the forum and judge shopping provisions. They also feared that the presiding judge, who may be a close friend of the trial judge from whom a change of judge is sought, will submit a panel of undesirable judges.

In order to meet this latter objection, the Association will amend its proposal and will ask the Indiana Supreme Court to adopt automatic

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[91]Act approved March 8, 1984, Pub. L. 170-1984, sec. 4, 1984 Ind. Acts 1389, 1392 (codified at Ind. Code § 35-36-1 (Supp. 1987)).

[92]State *ex rel.* Jeffries v. Lawrence Circuit Court, 467 N.E.2d 741 (Ind. 1984); *see also* State *ex rel.* Robinson v. Grant Superior Court, 471 N.E.2d 302 (Ind. 1984).

[93]Ind. R. Tr. P. 76. It is this writer's understanding that Indiana is the only state that affords an automatic right to change of judge or change of venue. That fact alone does not make the rule good or bad; there are salutary purposes for such a rule as well as detrimental effects surrounding it.

[94]1986 Proposals, *supra* note 8, at 22-23.

change of venue and change of judge rules permitting an automatic change in both civil and criminal cases,[95] if the party seeking the automatic change files a motion within twenty days following the entry of the preliminary plea in a criminal case or within ten days after the closing of the pleadings in a civil case. The right to an automatic change would be renewed in the event a presiding judge is determined to transfer a case to a new judge or county. The motions for automatic change of judge or venue, if timely filed, would be certified to the supreme court. The supreme court would then appoint a special judge or name a court in a contiguous county within the district. This should overcome the objections of those who fear that the presiding judge's decision might be motivated by improper considerations.

IV. Selecting Judges

Partisan selection of judges does little to further the goal of selecting qualified and competent people to the bench. Most voters do not have enough information to determine who is or is not qualified to be a judge. No one doubts that the voters are not qualified to choose the one among practicing physicians who ought to be the chief of the medical staff of the local hospital. Nevertheless, with little questioning the voters are permitted to select the attorney among all the attorneys in the county who will most competently, judicially, and fairly determine the course of many people's lives. The partisan selection process seems to be contrary to the goal of selecting an independent judiciary, one that will be fair to all segments of society—rich and poor, Democrats and Republicans.

We should consider other ways of selecting judges. One example is a non-partisan selection system.[96] Under a non-partisan system, candidates for judicial office do not align themselves with a political party. At the same time, the voters choose the judge. Nevertheless, attorneys must still incur the time and expense of a campaign for office without the benefit that comes from association with a political party. Some critics of the non-partisan election approach argue that, because candidates do not have the benefit of party support, candidates will align with special interest groups or individuals in order to obtain funding. Thus, the special interest group or individual will pressure the successful candidate to repay the "debt" after he becomes a judge.

Another selection method that ought to be considered is a merit selection system similar to the one used to select justices and judges to

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[95]The Association might except misdemeanor, infraction and ordinance violation cases.

[96]Vanderburgh County uses a non-partisan system to elect its circuit court and superior court judges. Ind. Code § 33-5-43.2-1.

the Indiana Supreme Court and the Court of Appeals.[97] District or county judicial selection committees could be formed that would select judges. From time to time, at intervals shorter than the ten-year interval used for appellate level judges,[98] the judges would stand for a retention vote. Critics note, however, that placing the authority for selecting judges in selection committees permits concentration of political influence that can lead to abuses. The advantages of this system include local input, screening on the basis of merit, and preservation of the electorate's rights to determine retention.

Although the Judges Association recommended retention of current systems of judical selection, that position has been reassessed. The Association will be recommending to the Commission that the partisan election system be abondoned in favor of a more suitable means of selecting Indiana's trial judges.[99]

V. Attracting and Keeping Competent Attorneys on the Bench

Because the state's trial court judges are selected from the state's practicing attorneys, the state should provide incentives that attract competent attorneys to the bench and keep them there. Well-qualified attorneys should think of serving as a judge as a desireable career alternative to private practice. Of the factors that attract competent attorneys to the judiciary and keep them there, three are more important than others: (1) adequate salaries, (2) pensions, and (3) job security.

Competent attorneys who become judges may never receive the salaries they would have received had they remained in private practice. Nevertheless, judges' salaries should at least allow the attorney who becomes a judge to maintain a standard of living that does not amount to financial punishment to the judge and the judge's family; however, for many years, Indiana's judges have been the lowest paid in the nation. The General Assembly has begun to address that issue.[100]

Indiana's judges now have two different pension plans.[101] One plan applies to persons who became judges before September 1, 1985. These judges are eligible to receive pension benefits when they have reached age sixty-two and have served eight years.[102] Those who elect to receive

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[97] Ind. Const. art. VII, § 10.

[98] *Id.* art. VII, § 11.

[99] Telephone interview with Judge Baker, President of the Indiana Judges Association (Dec. 21, 1987).

[100] *See* Ind. Code §§ 33-13-12-7 to -9 (Supp. 1987).

[101] *Id.* §§ 33-13-9.1-1 to -8 (Supp. 1987) (applies to persons who began service as a judge before September 1, 1985) and §§ 33-13-10.1-1 to -12 (Supp. 1987) (applies to persons who began service as a judge after August 31, 1985).

[102] *Id.* § 33-13-9.1-4(a) (Supp. 1987).

benefits before they reach age sixty-five receive reduced benefits.[103] The amount of the judge's annual benefit is the salary being paid for the office in which the judge served multiplied by a percentage that varies according to the judge's years of service.[104] Thus, as the sitting judge's salary increases, the benefit paid to the former judge increases. On the other hand, a judge who began, or will begin, to serve after August 31, 1985, and who, at the time he leaves office, has at least eight years of service receives a percentage of the salary the judge received when he separated from service.[105] Consequently, the pension benefits of these judges do not allow for inflation and cost of living increases. Because attorneys who are considering a career on the bench are concerned about pensions, this pension benefits freeze will tend to discourage attorneys from becoming judges.

Job security is another important consideration for attorneys who might leave private practice to become a judge. Frankly, every attorney must realize that whether he becomes or remains a judge has little to do with his merit and qualifications. It is a fact of political life that name recognition is a primary factor in any popular election. Moreover, the attorney must consider whether he wants to run a campaign against an incumbent who may win and hold a grudge for years. Even if the attorney wins, he must consider the possibility, perhaps probability, that he will remain in office for only one term, after having given up the clients, office space, books, and employees he had while in private practice.

Not only must the attorney seeking the position consider the decreased salary, the expense of mounting a campaign against a better known incumbent, and the probable loss of accumulated assets, clients, and employees, he must also be aware of the ethical restrictions on attorneys and judges who campaign for office. A campaign for judicial office is extremely hard to wage because many attorneys and judges feel that it is unethical to make an issue of how the candidate would rule in certain types of cases. Many judges who run on such platforms find that it becomes difficult or impossible to keep campaign promises because attorneys and litigants perceive them as unfair, prejudiced, and biased. These attorneys and litigants make every effort, through change of judge or change of venue, to remove the judge from the case. Conversely, those who choose not to make such campaign promises find that it is extremely difficult to campaign without issues to discuss with the voters. At the same time, the candidate who tries to wage a campaign based

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[103] *Id.* § 33-13-9.1-4(d).
[104] *Id.* § 33-13-9.1-4(b).
[105] *Id.* § 33-13-10.1-7.

on a scholarly analysis of the judicial system and proposed methods of improving it will probably find that the voters do not understand the issues and that such a campaign accomplishes no particular purpose. These are the dilemmas that qualified attorneys who aspire to judicial office currently face, and they are among the reasons why we need to reform our judicial system.

VI. Other Issues

Some judges are concerned that the presiding judge's power to transfer judges within the district will mean that trial judges will find themselves performing judicial duties in a county in which they were not elected and that such transfers will cause a great deal of inefficiency in the judicial process. Clearly such transfers would create much "dead time" while the judge is traveling, waiting for courtrooms, and waiting for litigants.

Occasionally, transferring a judge or judges may be the best way to alleviate case backlogs. Nevertheless, this is not likely to become a common practice; more often cases will be transferred to the judges. This will permit the judge to use a staff with which he is familiar, and it will be a more efficient use of court facilities and judicial resources. Instead of wasting "dead time," the judge will be able to spend more time in chambers where even a little time can be used to complete daily paperwork.

Transferring cases to judges instead of transferring judges to cases will mean that litigants and their counsel will have more traveling time. On the other hand, in exchange for the inconvenience of additional travel, litigants might expect to have more expeditious rulings. Also, litigants and their counsel already spend such traveling time, in many cases, because of change of venue.

Some judges are concerned about the effect the Judges Association's proposal will have on the judge's confidential employees. The proposal will permit some degree of pooling of non-confidential employees.[106] Pooling clerk-typists, bailiffs, and administrative personnel should be a more efficient use of these employees' time and should improve the overall efficiency of the system. Nevertheless, each judge could still have one or more confidential employees who work only for that judge. Obviously, these matters could be included in the circuit and district plans.

Judges are also concerned about the means of disciplining trial court judges. Currently, the Judicial Nominating Commission, whose primary

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[106]The proposal permits the presiding judge to assign non-confidential court personnel. 1986 Proposal, *supra* note 8, at 13.

function is to select nominees for the supreme court and the court of appeals, is also responsible for trial court judge discipline.[107] The Commission includes the Chief Justice, three attorneys, and three non-attorneys.[108] Although non-attorneys may have an adequate foundation upon which to make determinations regarding appointments to the appellate level judiciary, in many respects they lack the experience and knowledge to make determinations relating to disciplinary matters concerning trial court judges. Therefore, the Judges Association is recommending that the Chief Justice appoint a separate and distinct disciplinary board and that this board should include either or both sitting or retired judges.[109]

VII. Conclusion

Many have responded to the proposals for improving the judicial system with the cautionary adage, "If it ain't broke, don't fix it." Similarly, the manual typewriter of bygone days may still be functional, but in the modern day world of word processing its continued utility is questionable.

While society generally has entered the world of word processing, the court system in Indiana, in an equal number of respects, continues to operate as a manual typewriter. Because of structural and administrative inefficiencies, the system's ability to continue to cope with the demands of society has decreased. "Fixing" the system is no longer sufficient; it is time for a review and improvements of the entire system. This will require an extremely careful consideration of governmental functions and of the needs and concerns of the bench, the bar, and the citizens of Indiana. All should be and are encouraged to participate so that the needs of each will be served. The task is complex, but it is time to get on with it.

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[107] Ind. Code §§ 33-2.1-6-1 to -30.

[108] *See* Ind. Const. art. VII, § 9; Ind. Code §§ 33-2.1-4-1, -2.

[109] 1986 Proposal, *supra* note 8, at 14.

Developments in Professional Responsibility

Donald L. Jackson*

I. Introduction

There were several significant developments during the survey period in the area of professional responsibility. Most notable, of course, was Indiana's adoption of the Model Rules of Professional Conduct.[1] This article, however, focuses on the case law developments in this area, and, in this regard, the Indiana Supreme Court decided several disciplinary cases involving many types of attorney misconduct.[2] Although a number of these disciplinary cases, as well as several non-disciplinary cases involving professional conduct, are quite interesting and should be noted,[3] this article discusses three particularly comment-worthy cases that address novel issues in Indiana law. The analysis of each case is devoted to providing a better understanding of a lawyer's duties under the Code of Professional Responsibility, and, where appropriate, the discussion explains the impact of the new rules on the particular case being discussed.

II. The Ethical Requirements Applicable to Fees Paid in Advance of the Performance of Legal Services

A. *The Current Rule in Indiana*

The Indiana Supreme Court, in *In re Stanton*[4] (*Stanton II*), delivered the first opinion squarely addressing whether a flat fee paid to an

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[1]The Rules of Professional Conduct became effective in Indiana on January 1, 1987. Indiana Rules of Professional Conduct (1987) [hereinafter Rules].

[2]*See* 1986-87 Indiana Sup. Ct. Disciplinary Comm'n Annual Report.

[3]Among these are: *In re* Alexander, 504 N.E.2d 584 (Ind. 1987) (attorney committed misconduct by representing clients in dissolution actions while acting as county prosecutor); *In re* Morton, 504 N.E.2d 279 (Ind. 1987) (attorney committed misconduct by commingling client and attorney funds, by failing to account for client funds, and by failing to pay the funds over to the client); Midland-Guardian Co. v. United Consumer Club, Inc., 499 N.E.2d 792 (Ind. Ct. App. 1986) (attorney's testimony did not violate the witness-advocate rule where it was limited to the nature and value of his services and the right to attorneys' fees was not a contested issue); *In re* Tew, 498 N.E.2d (Ind. 1986) (attorney committed misconduct by entering into business transaction with client and making personal loans to himself from client funds on note containing forgiveness clauses).

[4]504 N.E.2d 1 (Ind. 1987).

attorney by a client at the beginning of the attorney's representation must be maintained in a separate bank account and accounted for pursuant to the requirements of the Code of Professional Responsibility. These segregation and accounting requirements were in Disciplinary Rule 9-102, which has been superseded by Indiana's version of the Model Rules of Professional Conduct.[5] The *Stanton II* court stated that the segregation and accounting requirements of Disciplinary Rule 9-102(A) "are not applicable to attorney fees charged in advance for the performance of legal services."[6] Thus, Indiana attorneys may commingle funds received from a client to the extent those funds can be characterized as advance fees.

The court addressed this issue after granting a petition to rehear *Stanton I*,[7] but limited the rehearing to clarifying the ethical requirements where the client pays the fee before the attorney performs the legal services.[8] The issues presented in *Stanton I*, however, required the court to decide a number of other issues relating to attorney misconduct. In *Stanton I*, the respondent was charged with eleven counts of ethical violations,[9] and the court found that the respondent had committed misconduct under six of the eleven counts.[10] Under counts VI, VII, and VIII, the court found that the respondent had received advance fees for legal services and that the respondent failed to account for the fees, failed to keep records of the fees, and failed to refund the fees after the attorney-client relationship had terminated and the fees had not been earned.[11] Also, the respondent was charged under count X with engaging in a "pattern of conduct" in violation of Disciplinary Rule 1-102(A)(4), (5) and (6). Apparently, the Disciplinary Commission's theory under count X was that because the respondent, among other things, failed to segregate his clients' advance fees from his personal funds pursuant to the segregation and accounting dictates of Disciplinary Rule 9-102, the respondent had engaged in conduct involving dishonesty, fraud, deceit or misrepresentation, engaged in conduct prejudicial to the administration of justice, and engaged in conduct adversely affecting his fitness to practice law.[12]

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[5]Rules, *supra* note 1, Rule 1.15.

[6]504 N.E.2d at 1.

[7]*In re* Stanton, 492 N.E.2d 1056 (Ind. 1986).

[8]504 N.E.2d at 1.

[9]The respondent was charged with violations of the following disciplinary rules: DR 1-102(A)(4), (5) and (6); DR 2-110(A); DR 2-105(A); DR 2-106; DR 2-109(A)(3); DR 6-101(A)(3); DR 7-101(A)(2)(3); DR 9-102(A)(2); DR 9-102(B)(4).

[10]492 N.E.2d at 1063.

[11]*Id.* at 1060-62.

[12]*Id.* at 1062. Count X, therefore, was brought under DR 1-102(A)(4), (5) and (6)

The court noted that because the respondent was not charged specifically with violations of Disciplinary Rule 9-102 and because Disciplinary Rule 2-109(A)(3), which required the refund of all unearned fees, was the only disciplinary rule applicable to the fees, count X was repetitious.[13] This ruling set the stage for *Stanton II* in which the court reheard count X in order to clarify "the relationship of Disciplinary Rule 9-102(A)(2) and 9-102(B)(3) in comparison with Disciplinary Rule 2-109(A)(3)."[14]

The *Stanton II* court noted that Disciplinary Rule 9-102 ordinarily applied to funds in the nature of settlements or other properties received on behalf of a client. The court summarily held that Disciplinary Rule 9-102 did not apply to advance fees and that advance fees could be used or commingled at the will of the attorney, although the attorney would be required to refund any of the advance fee not earned.[15]

The court's reasoning in *Stanton II* is questionable, and the decision is inconsistent with a prior Indiana ethics opinion. The court did not even mention a 1977 Indiana State Bar Association legal ethics opinion that stated, "With respect to client advances which specifically represent 'retainer advances' against an attorney's anticipated legal fees, said advances must be deposited in one or more identifiable bank accounts in accordance with Disciplinary Rule 9-102(A) and Disciplinary Rule 9-102(A)(2); said advances may not be deposited in a firm name account or otherwise commingled with the funds of the attorney or his law firm."[16] Also, the court did not refer to or attempt to distinguish *In re Yussman*,[17] which arguably applies to the facts in *Stanton II*.[18] Thus, the court in *Stanton II* disregarded the view that "some advance fee payments, and perhaps even retainer fees, must be deposited into a trust account and withdrawn only as the lawyer earns the fees" so as to comply with Disciplinary Rule 9-102.[19] The Indiana State Bar Association Legal Ethics Committee has adopted this view, and so have

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and not DR 9-102. The same theory was asserted in *In re* Yussmann, 487 N.E.2d 161 (Ind. 1986), where an attorney had commingled and used client funds that were labeled as a "retainer" contrary to an employment agreement which required such funds to be deposited in his firm's escrow account. In *Yussmann*, the attorney was charged with violations of DR 1-102(A)(4)(5) and (6) and 9 DR 9-102(A)(2). The court found that the attorney had committed misconduct by "his depositing and using the funds in question contrary to his agreement and to professional guidelines. . . ." *Id.* at 162.

[13]492 N.E.2d at 1062.

[14]*Stanton*, 504 N.E.2d at 1.

[15]*Stanton*, 504 N.E.2d 1.

[16]Indiana State Bar Ass'n, Op. 4 (1977).

[17]487 N.E.2d 161 (Ind. 1980).

[18]*See supra* note 12.

[19]C.W. Wolfram, Modern Legal Ethics § 4.8 at 178 (1986).

a majority of the states that have published legal ethics opinions on the subject.[20] The *Stanton II* court did not even discuss this view.

It is possible that the court simply bowed to the practical realities regarding fee collection facing the bar, particularly the criminal defense and domestic relations bar. Without doubt a ruling that advance fees must be segregated would have disconcerted many members of the Indiana Bar who have established, and rely on, the practice of collecting advance fees. These practical considerations are outweighed, however, by the sound policy that should have governed the interpretation of Disciplinary Rule 9-102. This disciplinary rule was intended to prevent commingling of attorney and client funds for two reasons: (1) to protect a client's funds from misappropriation, and (2) to avoid the appearance of impropriety.[21] These reasons apply to advance fee payments.

Moreover another disciplinary rule, Disciplinary Rule 2-110(A)(3), required an attorney to "refund promptly any part of the fee paid in advance that has not been earned."[22] Clearly this rule indicated that the client retained an interest in advance fees. If a client has an interest in the funds received by the attorney, it surely follows that the dangers of commingling and misappropriation are just as prevalent as they are when an attorney receives client funds for any other purpose. It seems contradictory that the court in *Stanton I* would find that the advance fees were client funds to the extent they had to be refunded pursuant to Disciplinary Rule 2-110(A)(3), but that the funds in question were not client funds that needed to be segregated pursuant to Disciplinary Rule 9-102(A)(2). The court's decision, then, creates a curious paradox: If a client is afforded the protection to have its unearned advance fee returned because the attorney did not earn the fee, how is the client afforded the protection that the unearned fee has not already been used, or that the lawyer is unable to refund what is owed to the client?

In order to better understand the court's decision in *Stanton II*, it is important to understand the ambiguity that existed in Disciplinary Rule 9-102, the confusing difference between advance fees and retainers, and the majority view that advance fees are best considered client funds for the purposes of the separation and accounting requirements of Disciplinary Rule 9-102.

B. Analysis of Disciplinary Rule 9-102 and the Prevailing View with Regard to Advance Fees

Disciplinary Rule 9-102(A), which has been superseded by Rule 1.15(a), required all client funds received by an attorney to be held

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[20]*See infra* note 32 and accompanying text.

[21]Indiana Code of Professional Responsibility , EC 9-5 (1981) [hereinafter Code].

[22]Code, *supra* note 21, DR 2-110(A)(3).

in a bank account separate from funds belonging to the attorney or the attorney's firm.[23] Funds can be received from a client in a variety of ways including settlement funds from lawsuits, estate distributions, deposits held in escrow, and advances for costs and expenses.[24] The requirements of Disciplinary Rule 9-102(A) are explicit and, thus, violations of this rule should be obvious to most practitioners.[25] There is, however, an aspect of Disciplinary Rule 9-102(A)(2) that is ambiguous.

Disciplinary Rule 9-102(A)(2) provided an exception to the rule requiring separation of client funds in cases where an attorney received funds which "presently or potentially" belonged to the attorney or the

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[23]Code, *supra* note 21, DR 9-102(A). DR 9-102 states:

(A) All funds of clients paid to a lawyer or law firm, other than advances for costs and expenses, shall be deposited in one or more identifiable bank accounts maintained in the state in which the law office is situated and no funds belonging to the lawyer or law firm shall be deposited therein except as follows:
  (1) Funds reasonably sufficient to pay bank charges may be deposited therein.
  (2) Funds belonging in part to a client and in part presently or potentially to the lawyer or law firm must be deposited therein, but the portion belonging to the lawyer or law firm may be withdrawn when due unless the right of the lawyer or law firm to receive it is disputed by the client, in which event the disputed portion shall not be withdrawn until the dispute is finally resolved.

(B) A lawyer shall:
  (1) Promptly notify a client of the receipt of his funds, securities, or other properties.
  (2) Identify and label securities and properties of a client promptly upon receipt and place them in a safe deposit box or other place of safety as soon as practicable.
  (3) Maintain complete records of all funds, securities, and other properties of a client coming into the possession of the lawyer and render appropriate accounts to his client regarding them.
  (4) Promptly pay or deliver to the client as requested by a client the funds, securities, or other properties in possession of the lawyer which the client is entitled to receive.

[24]*See* Note, *Attorney Misappropriation of Clients' Funds: A Study in Professional Responsibility*, 10 U. Mich. J.L. Ref. 415 (1977) [hereinafter *Attorney Misappropriation*].

[25]For example, there can be no doubt that DR 9-102 would be violated if an attorney settled a lawsuit on behalf of his client, received the settlement proceeds, cashed the check, and never paid the funds over to the client. *See In re* DeWitt, 268 Ind. 160, 374 N.E.2d 514 (1978). As another example, it is clear that where an attorney receives on behalf of a client partial distributions from an estate, fails to deposit those funds in a separate account and commingles the distribution with his own funds, that attorney has committed misconduct under DR 9-102. *See In re* Kesler, 272 Ind. 161, 397 N.E.2d 574 (1979), *cert. denied sub nom.* Kesler v. Indiana Supreme Court Disciplinary Comm'n, 449 U.S. 829 (1980).

attorney's firm.[26] These funds still must have been deposited in a separate account, but that portion of the funds that belonged to the attorney or the firm could have been withdrawn when due, unless the client disputed the portion in question.[27]

The ambiguity existed in cases where an attorney received advance fees from a client at the beginning of the attorney-client relationship.[28] Obviously these types of funds "presently or potentially" belonged to the attorney or the attorney's firm. Thus, these funds could have been the client's funds and should have been held separately. It is also possible to argue that because the funds were transferred to the attorney in anticipation of his legal fees, the funds lost their identity as client funds and were subject to Disciplinary Rule 9-102. The often confusing difference between funds received at the beginning of an attorney's representation that were considered as a fee advance and those that were characterized as a retainer compounds the ambiguity.[29]

Funds received from a client that are intended as an advance payment of legal fees are, in essence, a deposit for the payment of future services and a lawyer's protection against a client's refusal or inability to pay.[30] These funds can be confused with a retainer,[31] which has traditionally been defined as a nonrefundable amount that is paid solely to secure an attorney's, or firm's, general availability for particular matters and to prevent the attorney from representing a client's adversaries.[32] Although the confusion in terminology may seem a mere exercise in semantics, it should have been a critical issue for the purposes of Disciplinary Rule 9-102(A). The distinction between the character

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[26]Code, *supra* note 21, DR 9-102(A)(2).

[27]*Id.*

[28]*See, e.g.*, *Attorney Misappropriation*, *supra* note 24, at 415 n.2 (noting the ambiguity "as to whether prepaid legal fees for specified services . . . must be treated as client's money prior to performance of the legal services").

[29]One court faced with the question of whether an advance fee or retainer is subject to the DR 9-102 separation requirement balked at deciding the question because of the confusion in terminology. *In re* Zedric, 92 Wash. 2d 777, 782, 600 P.2d 1297, 1302 (1979) ("We note the apparent confusion about the status of retainer fees . . . . Until the bar association clarifies its position regarding retainer fees which have not been earned in full, we will not consider the issues . . . .").

[30]*See, e.g.*, New York State Bar Ass'n Op., 570 (1985).

[31]While defining retainer as a payment intended to secure the general availability of an attorney and preventing that attorney from representing the client's adversary, some authorities note that the term retainer can also "mean solely the [advance] compensation for services to be performed in a specific case." Blacks Law Dictionary, 1183 (5th ed. 1979). *See also* Illinois State Bar Ass'n Op. (BNA) 703 (1980).

[32]ABA Lawyers Manual on Professional Conduct (BNA), 45:104 (1985) [hereinafter Lawyers Manual]. *See also* Wisconsin State Bar Op. E-86-9 (1986); Hawaii Supreme Court Disciplinary Bd. Op. 29 (1985).

of the payment as either a fee advance or a retainer should have had an effect on a court's interpretation of the ambiguity in Disciplinary Rule 9-102(A)(2) as to whether funds received at the beginning of representation were client funds or were considered earned.[33]

Although there is almost no case law on the issue,[34] several state bar associations have considered whether advance fees were subject to the separation requirement of Disciplinary Rule 9-102. Most of state bar associations that have considered the issue have determined that fee advances belong to the client until earned and, thus, should be kept in an account separate from the attorney's account and identifiable as client funds.[35] Further, it is generally accepted that a true retainer, which is a fee paid to the attorney solely for the attorney's availability, becomes the attorney's property as soon as he receives it and need not be kept in a separate account.[36]

A few state bar associations do not view advance fees as client funds and do not require that they be separated from the attorney's funds.[37] Arguments that have been made against characterizing advance fees as client funds are compelling, but not persuasive. For example, some argue that because the term "fee" did not appear in Disciplinary Rule 9-102, the rule did not govern advance fees.[38] Also, various other

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[33]*See, e.g.*, *In re* Stern, 92 N.J. 611, 619, 458 A.2d 1279, 1983-84 (1983) (pending a clarification of the 1983 Model Rules, we "hold that absent an explicit understanding that the retainer fee be separately maintained, a general retainer fee need not be deposited in an attorney's trust account."). *But see In re* Aronson, 352 N.W.2d 17, 18 (Minn. 1984) (holding that an attorney's deposit of a "retainer fee" into a personal account violates DR 9-102(A)(2)).

[34]In *Stanton II*, 504 N.E.2d 1 (Ind. 1987), the focus of this discussion, is the only case to squarely decide the issue of whether advance fees are subject to the separation requirements of DR 9-102.

[35]Lawyers Manual, *supra* note 32, at 45:103-4 (citing Indiana State Bar Ass'n Op. 4 (1977); Massachusetts Op. 78-11 (1978); Oregon State Bar Op. 205 (1972); Oregon State Bar Op. 251 (1973); San Francisco Bar Ass'n Op. 1973-14 (1973)); Texas State Bar Op. 391 (1978); Virginia State Bar Op. 360 (N.D.). *See also* Hawaii Supreme Court Disciplinary Board Op. 29 (1985); Missouri Bar Admin. Op. 116 (1981); Oregon State Bar Ass'n Op. 454 (1980); San Francisco Bar Ass'n Op. 1980-1 (1980); Washington State Bar Ass'n Op. 173 (1980); Wisconsin State Bar Op. E-86-9 (1986).

[36]Lawyers Manual, *supra* note 32, at 45:104 ("retainers that secure a lawyer's general availability to a client, and are not related to the fee for a particular representation, belong to the lawyer and need not be segregated in client trust accounts."). *See also* Hawaii Supreme Court Disciplinary Bd. Op. 29 (1985); Missouri Bar Admin. Op. 116 (1981); Washington State Bar Ass'n Op. 173 (1980); Wisconsin State Bar Op. E-86-9 (1986).

[37]Lawyers Manual, *supra* note 32, at 45:104 (citing D.C. Op. 113 (1982); Florida Bar Op. 76-27 (1976); Maryland State Bar Ass'n Op. 83-62 (1983); New York State Bar Ass'n Op. 570 (1985)).

[38]*Legal Ethics Committee Proposed Opinion for Comment: Fees Advanced by Clients*,

provisions of the Model Code of Professional Responsibility specifically refered to the term "fee."[39] Thus, the argument continues, if the drafters inserted the word "fee" in parts of the Code yet failed to mention "fees" in Disciplinary Rule 9-102, then Disciplinary Rule 9-102 must not have been intended to govern advance fees.[40]

Another argument against requiring advance fees to be separately maintained focuses on the practical considerations, from an attorney's point of view, that surround fee arrangements. Attorneys often request fee advances in order to avoid problems with clients who do not pay for legal services after the services have been performed.[41] The New York State Bar Association has noted that this purpose would be defeated if fee advances were subject to Disciplinary Rule 9-102 and held in trust until the client dispute is resolved.[42]

An even more tenuous argument, which also ignores the interests of the client, focuses on the needs and practical realities of the practice of law by emphasizing the "unnecessarily disruptive" effect that the Disciplinary Rule 9-102 separation requirement would have on attorneys who commonly request advance fees.[43] It is possible that many bar associations, courts, and practitioners consider this argument the most compelling one. After all, requiring an attorney to completely overhaul his or her business in order to accommodate the rule "is likely to cause mischief."[44] It would be unfortunate, however, if avoiding such "mischief" became an underlying principle of an ethical code for lawyers.

The argument that advance fees need not be separately maintained is not persuasive and, as previously noted, most state bar associations have not accepted it.[45] Any response to the minority view should begin with the language of Disciplinary Rule 9-102(A) that states that all "client funds" paid to an attorney, except "advances for costs and expenses," shall be separately maintained.[46] The general, categorical

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Dist. Law., July-Aug. 1981 at 47, 53 [hereinafter *Proposed Opinion*] (arguing that "[b]asic logic compels the conclusion that the absence of any reference to 'fees' here [in DR 9-102] means that this DR is not intended to regulate fees.") (dissenting opinion).

[39]The term "fee" is used in the following code sections: (1) DR 2-106 "Fees for Legal Services;" (2) DR 2-107 "Division of Fees Among Lawyers;" and (3) DR 3-102 "Dividing Legal Fees with a Non-Lawyer."

[40]*Proposed Opinion*, *supra* note 38, at 53.

[41]19 New York State Bar Ass'n Op. 570 (1985).

[42]*Id.*

[43]*Proposed Opinion*, *supra* note 38, at 52. (This argument was advanced in a dissenting opinion. The proposed draft opinion favored the application of DR 9-102 to advanced fees.)

[44]*Id.* at 56.

[45]*See supra* note 35 and accompanying text.

[46]Code, *supra* note 21, DR 9-102(A).

reference to *all* client funds followed by the limited and specific exclusion indicates that the rule governs even advance fees.[47]

Having reviewed this seemingly academic debate (because the Code no longer applies in Indiana), it is logical to discuss what impact the new Rules of Professional Conduct will have on this issue. Although *Stanton II* was decided under Disciplinary Rule 9-102, the counterpart to this provision in the new Rules should not change the law, and, in fact, probably supports the holding that advance fee payments need not be maintained in a separate account. The new rule governing this issue is entitled "Safekeeping Property,"[48] and although the drafters of the new rules may have intended to broaden the scope of the former rule regarding client funds, there is a very good argument that Rule 1.15 is not broad enough to cover advance fees.

The rule provides, "A lawyer shall hold *property of clients* . . . that is in a lawyer's possession in connection with the representation separate from the lawyer's own property."[49] This rule also requires that "funds" be held in a separate account and "other property" be appropriately safeguarded.[50] Clearly, then, the phrase "property of clients" in the first part of the rule is intended to cover client funds. This seems to place Rule 1.15 on equal footing with Disciplinary Rule 9-102 in that client funds must be maintained separately. The debate over whether an advanced fee is client funds could begin here; but, because of *Stanton II*, it should now be clear in Indiana that advance fee payments do not constitute client funds. Additionally, the new rules distinguish between "property of clients" and an advanced fee payment.[51]

Under Rule 1.16(d), a lawyer must, at the end of his representation of the client, "take steps reasonably practicable to protect a client's interest, such as . . . surrendering papers and *property* to which the client is entitled and *refunding any advance payment of fee* that has not been earned."[52] Thus, even if one could argue that the all encompassing term "property," as used in Rule 1.15, covers advance fee payments, the drafters have effectively preempted that argument because the term "property" in Rule 1.16 does not include "advance payment

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[47]*See Proposed Opinion*, *supra* note 38, at 48 ("We do not think that the drafters of the Code would have used such an all-inclusive term if in fact they had intended to reach only limited categories . . . of funds including client funds to be delivered to a third party or delivered to the client from a third party.")

[48]RULES, *supra* note 1, Rule 1.15.

[49]*Id.* (emphasis added).

[50]*Id.*

[51]*Id.* Rule 1.16.

[52]*Id.* (emphasis added).

of fees." Apparently, then, the debate over advanced fees has ended, whether based on the decision in *Stanton II* or the language of the new rules. Thus, lawyers in Indiana need not maintain attorney fees paid in advance in a separate trust account.

III. Denial of a Fair Trial Based on an Advocate's Ethical Violation in a Civil Case

Another important case that was decided during the survey period is *Jackson v. Russell*.[53] This lawsuit originated when two businessmen, who were attempting to agree on the terms of a joint-venture, reached an impasse while negotiating the financing terms.[54] Although *Jackson* is a civil case for damages, the court discusses important ethical questions relating to the witness-advocate rule.[55]

The plaintiff in *Jackson* was the president and chief operating officer of Como Plastic Corp. a wholly-owned subsidiary of PPG Industries, Inc. The plaintiff and defendant together made plans to form a joint venture, with the defendant providing the financing, to purchase Como from PPG. The attorneys for both parties met to negotiate the terms of the transaction; however, throughout the negotiations the plaintiff consistently rejected a buy-sell agreement offered by the defendant. On the scheduled closing date, the parties reached an impasse on this issue and the defendant refused to go forward. Soon after the deal failed, the defendant approached PPG and offered to buy Como himself. Although the plaintiff threatened to sue, the defendant and PPG reached an agreement that was almost identical to the original sale agreement, and PPG sold Como to the defendant.

The plaintiff, having agreed not to sue PPG, brought suit against the defendant alleging, among other things, tortious interference with contractual relations. The defendant filed a third party claim against PPG for breach of warranty, and PPG moved to dismiss the defendant's lead counsel when it appeared that members of the lead counsel's firm, which had represented the defendant during the joint venture negotiations, would be called to testify at the trial. The court denied PPG's motion because the defendant's lawyers assured the trial court that members of the firm would not be called as witnesses. Nevertheless, after one week of trial, the trial court was forced to disqualify the

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[53]498 N.E.2d 22 (Ind. Ct. App. 1986).

[54]*Id.* at 26.

[55]The witness-advocate rule was embodied in DR 5-101(B) and DR 5-101(A). The rule prohibited an attorney from acting as an advocate in a trial in which the attorney ought to be called as a witness, and where the rule applies, the attorney and his firm must withdraw from the case. Code, *supra* note 21, DR 5-102(B).

law firm because it became clear that members of the firm would appear as witnesses. In what appears to be a compromise, the trial court accepted the law firm's plan under which the defendant's local counsel, who was not a member of the firm, would act as lead counsel, and the lawyers from the firm would be permitted only to assist silently at the counsel table. The trial resumed and the jury found the defendant guilty of tortious interference, constructive fraud, breach of fiduciary duty, and criminal mischief. The jury awarded the plaintiff damages of two million dollars.[56]

On appeal the defendant argued, among other things, that his right to a fair trial had been impaired because the trial court did not declare a mistrial after the defendant's lead counsel was disqualified. To support this argument, the defendant claimed that the trial court's failure to declare a mistrial forced him to proceed after one week of trial with new lead counsel who was not as familiar with his case as were the disqualified attorneys. Further, the defendant argued that the sudden appearance, in a jury trial, of new lead counsel with the disqualified attorney sitting silently at the counsel table prejudiced his case. Finally, the defendant asserted that not only did his lawyers fail to inform him of the potential ethical problem and its consequences, but the opposing counsel and the trial court also failed to raise the questions early enough in the course of the litigation. The court of appeals grouped these arguments together under the broad claim that the trial court erred in not declaring a mistrial and first discussed "the ethical considerations present when an attorney serves both as advocate and witness in a case."[57]

The witness-advocate rule provides that when a trial lawyer learns "or it is obvious" that the lawyer or a member of his firm "ought to be called as a witness on behalf of his client," the lawyer must withdraw from representing the client so that the lawyer can testify.[58] Although violation of this, or any, disciplinary rule could result in attorney discipline, this rule is frequently invoked in the course of litigation, because courts generally accept a violation of the rule as a basis for a motion to disqualify the would-be testifying attorney from continuing as an advocate in the case.[59]

In *Jackson*, the court of appeals held that trial court properly disqualified the defendant's lawyers[60] and relied on the policy argument often cited as the basis for the witness-advocate rule—the protection

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[56]498 N.E.2d at 28.

[57]*Id.* at 29.

[58]CODE, *supra* note 21, DR 5-102(A).

[59]C.W. WOLFRAM, MODERN LEGAL ETHICS § 7.5.1 at 375 (1986).

[60]498 N.E.2d 22, 30.

of the interests of the client, the opposing party, and the reputation of the bar in general.[61] The court stated that it matters little whether the lawyer-witness actually testifies at trial. Rather, the proper test in determining whether an attorney should be disqualified under Disciplinary Rule 5-102 is "whether the attorney's testimony could be significantly useful to the client; if so, he or she ought to be called."[62] Further, as the rule indicates, the attorney is unable to choose whether to be an advocate or a witness. If the test is met, an attorney must withdraw in favor of testifying on behalf of the client.[63]

The court also considered the hardship exception to Disciplinary Rule 5-102. Under the proper circumstances, a lawyer may continue to represent a client even if the lawyer or a lawyer from the lawyer's firm ought to be called as a witness, if the withdrawal "would work a substantial hardship on the client because of the distinctive value of the lawyer or his firm as counsel on a particular case."[64] The court stated that this exception should apply only in the most extraordinary cases, and that it was not appropriate in a case where, as in *Jackson*, a possible disqualification was apparent from the beginning of the litigation and the issue did not appear suddenly and unexpectedly.[65]

Having determined that the trial court properly disqualified the defendant's attorneys, the court then considered whether a party in a civil case has been denied his right to a fair trial if his lead counsel has been disqualified. In a criminal case, ineffective counsel can deny a defendant his right to a fair trial under the sixth and fourteenth amendments;[66] however, ineffective counsel is not ordinarily grounds for reversal in a civil case.[67] Nevertheless, the court of appeals in *Jackson* said, "[A] violation of the CPR that prevents a fair trial would constitute reversible error. . . ."[68] Having said this, the court then had to determine a most difficult and controversial question—whether this particular violation was reversible error.

The *Jackson* court asserted several reasons to support its conclusion that the defendant was not entitled to a new trial because of the trial court's disqualification procedure. First, the court rejected the defendant's contention that his own lawyers prejudiced his case by forcing him into a rash decision regarding the substitution of counsel.[69] The

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[61] *Id.* at 29.
[62] *Id.* at 30.
[63] *Id.*
[64] CODE, *supra* note 21, DR 5-101(B)(4).
[65] 498 N.E.2d at 30.
[66] *See, e.g.*, Johnson v. Rutoskey, 472 N.E.2d 620, 623 (Ind. Ct. App. 1984).
[67] *Id.*
[68] *Jackson*, 498 N.E.2d at 31.
[69] *Id.*

court found that the defendant was fully informed of the possible ethical problems and was also aware of the consequences.[70] Also, the court noted that given the defendant's business acumen and his prior experience with legal matters it was unlikely the defendant was forced into an uninformed decision. Alternately, the court said that the defendant waived any right to a mistrial.[71] Testimony from the disqualification discussion revealed that the defendant was aware of and acquiesced in the disqualification plan.[72] In concluding that the defendant had waived any right to a mistrial, the court stated, "Clearly, [defendant] was aware of what had transpired and acquiesced in the procedure employed by the court."[73]

Finally, even if the defendant had not waived the right to a mistrial, the court concluded that the defendant failed to show any prejudice in the trial court's disqualification procedure. The court rejected the defendant's argument that he was prejudiced when the trial resumed the second week with a change in the lead counsel. Noting that the defendant's new lead counsel had been at the counsel table from the beginning of the trial, and that the disqualified attorneys were allowed to remain silently at the counsel table, the court considered this argument speculative.[74] Also, the court refused to hold that the new lead counsel's unfamiliarity with the case prejudiced the defendant. Because the disqualified lawyers were still allowed to assist the new lead counsel, and because the defendant failed to show any specific examples of error committed by the lead counsel, the defendant failed to prove any grounds for reversal.[75]

The Model Rules of Professional Conduct, eliminate the problem that confronted the defendant in *Jackson*. The counterpart to Disciplinary Rule 5-102(A), Rule 3.7, is substantially similar to the old rule except that Rule 3.7(b) provides, even if the witness-advocate rule would otherwise apply, "A lawyer may act as advocate in a trial in which another lawyer in the lawyer's firm is likely to be called as a

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[70]The court quoted portions of the testimony from the disqualification discussions which indicated that the defendant understood the proceedings. For example, in response to a question by an attorney from the firm as to whether withdrawal of the firm would work a hardship, the defendant answered, "I have been advised where we are on this and have felt comfortable with it . . . ." *Id.*

[71]*Id.*

[72]The testimony revealed repeated questions from the defendant's new lead counsel to the defendant asking whether he understood and agreed with the disqualification plan. In response to each question, the defendant unequivocally affirmed his understanding and acquiescence. *Id.* at 31-32.

[73]*Id.* at 32.

[74]*Id.* at 33.

[75]*Id.*

witness unless precluded from doing so by [the general conflict of interest and prohibited transaction rules]."[76] Clearly, then, the original trial counsel for the defendant in *Jackson* could have continued to represent the defendant even though lawyers from the same firm were likely to be called as witnesses. Perhaps the *Jackson* court anticipated the rule change. The court stated that the trial court's plan resolved the disqualification problem "in a manner feasible and fair to all those involved."[77]

Although a fair reading of Disciplinary Rule 5-102(A) would appear to have required the firm to be disqualified from even silently assisting the lead counsel, the plan, which disqualified the law firm only to the extent that its lawyers were not permitted to speak on behalf of the defendant in court, appears to have merged the old and new rules. Nevertheless, the situation presented in *Jackson* is no longer a problem, and lawyers who represent clients in transactional or business matters need not worry that lawyers in their firm would be disqualified from representing these clients if the same matters were to ultimately end in litigation.

IV. Part-Time Deputy Prosecutors: Avoiding Conflicts of Interests with Private Clients

Many communities rely on part-time government lawyers who concurrently maintain a private practice, possibly with a law firm.[78] For example, a majority of prosecutors in the United States are not full-time government lawyers.[79] Attorneys who maintain a private practice while also acting as part-time prosecutors are keenly aware of the potential conflicts that arise as a result of this type of multiple representation. Formerly, this conflict surfaced when a part-time prosecutor represented clients in private practice in dissolution matters. The conflict existed because of the requirement that the prosecutor appear in uncontested dissolution proceedings and because traditionally prosecutors defended against those proceedings.[80] This role was defined by statutes, which have since been repealed,[81] and by a very old line of Indiana

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[76]Rules, *supra* note 1, Rule 3.7(b).

[77]*Jackson*, 498 N.E.2d at 33.

[78]C.W. Wolfram, Modern Legal Ethics § 8.9.4 at 454 (1986).

[79]*Id.* at 455 (citing U.S. Dept. of Justice (LEAA), State and Local Prosecution and Civil Attorney Systems 4 (1978); Comment, *The Part-time State's Attorney in South Dakota: The Conflict Between Fealty to Private Client and Service to the Public*, 227 S.D.L. Rev. 24, 28 (1981)).

[80]*See In re* Reed, 500 N.E.2d 1189 (Ind. 1986).

[81]*See, e.g.*, Ind. Code § 31-1-12-20 (1971), *repealed by* Act of April 1, 1971, § 1, 1971 Ind. Acts 1956; Ind. Code § 31-1-21-1 to -3 (1971), *repealed by* Act of April 8, 1971, § 1, 1971 Ind. Acts 1956.

cases that established "the duty of prosecuting attorneys, whenever any petition for divorce remains undefended, to appear and resist the petition."[82] The duty referred to in those cases was derived purely from the state interest in maintaining the family relation and in preventing collusive dissolution of the marital relation.[83]

Although the duty to defend against uncontested dissolutions has been repealed by statute, and the case law on this issue is somewhat outdated, there is still good reason to believe that a part-time prosecutor has some duty on behalf of the State to intervene in dissolution-related matters.[84] If a duty can be established, there can be no doubt that it would be a conflict of interest for a part-time prosecutor to engage in the representation of clients in dissolution-related matters. This creates a serious dilemma for a part-time prosecutor who must decline all dissolution-related cases in private practice or risk violating the rules.

The Indiana Supreme Court resolved, at least partially, this dilemma in *In re Reed*.[85] *Reed* involved a disciplinary proceeding against a duly appointed deputy prosecuting attorney who had accepted and continued private employment in matters involving child support and custody.[86] The court recognized the prior duty of prosecutors to defend against dissolution proceedings and the current duty of prosecutors to act in "various matters relating to dissolution and support. . . ."[87] Rather than focusing on whether a real conflict results because of such a duty, the court, recognizing that part-time deputy prosecuting positions can best be filled with experienced local attorneys only by allowing those attorneys to continue in their private practice, reached a compromise that avoids conflicts of the nature involved in *Reed*. The court held, "Where the employment of such part-time deputy prosecutors is predicated upon a prior, express written limitation of responsibility to exclude dissolution-related matters, we can find no reasonable purpose for perpetuating the prohibition against involvement in dissolution cases

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[82]*See* State v. Brinneman, 120 Ind. 357, 358, 22 N.E. 332, 333 (1889). *See also* Scott v. Scott, 17 Ind. 309 (1861); Yeager v. Yeager, 43 Ind. App. 313, 87 N.E. 144 (1908).

[83]*Brinneman*, 120 Ind. at 358, 22 N.E. at 333.

[84]The most obvious basis for such a duty can be derived from an Indiana statute requiring prosecuting attorneys to prosecute the enforcement of support agreements. *See* IND. CODE § 31-2-1-12 (1982).

[85]500 N.E.2d 1189 (1986).

[86]*Id.* at 1190. The court did not explain under which disciplinary rules respondent was charged; however, it is most likely that he was charged under DR 5-102 relating to conflicts of interest. The counterpart to this provision in the new Rules is Rule 1.7. RULES, *supra* note 1, Rule 1.7.

[87]*Reed*, 500 N.E.2d at 1190.

in their private law practice.''[88] Based on this holding, and on the unavailability of any evidence that the respondent's duties in *Reed* expressly excluded dissolution-related matters, the court refused to approve the parties' joint statement of circumstances and conditional agreements.[89] The court's apparent compromise removes the disincentive that may have prevented qualified, and otherwise eager, local attorneys from accepting part-time deputy prosecutor positions solely because their acceptance would curtail the family law aspect of their private practice.

The *Reed* court also noted that its rationale ''would apply also to the professional standards embodied in the [Rules of Professional Conduct].''[90]

The then Chief Justice Given agreed with the majority but ''disagree[d] with the practice of using an opinion to change the rules . . . .''[91] He added, ''[A]ttorneys should be entitled to turn to the rule book and get a succinct statement as to what the rule of procedure is in a given instance.''[92] Apparently, the court has done what the former Chief Justice suggested.[93]

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[88] *Id.*

[89] *Id.*

[90] *Id.* at 1190, n.1.

[91] *Id.* at 1191 (Given, C.J, concurring).

[92] *Id.*

[93] Effective September 4, 1987, the Indiana Supreme Court promulgated Rule 1.8(k) which states:

> (k) A part-time prosecutor or deputy prosecutor authorized by statute to otherwise engage in the practice of law shall refrain from representing a private client in any matter wherein exists an issue upon which said prosecutor has statutory prosecutorial authority or responsibilities. This restriction is not intended to prohibit representation in tort cases in which investigation and any prosecution of infractions has terminated, nor to prohibit representation in family law matters involving no issue subject to prosecutorial authority or responsibilities. Upon a prior, express written limitation of responsibility to exclude prosecutorial authority in matters related to family law, a part-time deputy prosecutor may fully represent private clients in cases involving family law.

RULES, *supra* note 1, Rule 1.8(k).

Indiana Rules of Professional Conduct: A Comparison with the Old Code

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I. Background and Overview

The Indiana Rules of Professional Conduct are based almost entirely on the American Bar Association (ABA) Model Rules of Professional Conduct.[1] Because of concern over the efficiency of the Model Rules of Professional Responsibility, upon which Indiana and other states had based professional conduct codes, the ABA in 1977 appointed a commission chaired by Robert J. Kutak to draft new rules.[2] The Model Rules went through several changes in the stages between the draft prepared by the Kutak Commission and the final version of the Model Rules adopted by the ABA House of Delegates in August of 1983. A brief overview of some of these changes gives light to the concerns about attorney conduct held by both the members of the Kutak Commission and the ABA Delegates as a whole.

In the Discussion Draft of the Model Rules, the language of Rule 6.1 "required" that attorneys perform pro bono work.[3] However, in the final version of the Model Rules, Rule 6.1 was tempered and attorneys were only "encouraged" to perform or support pro bono work.[4] Next, Discussion Draft Model Rule 1.5 sought to require that all fee arrangements be in writing.[5] By the time the ABA House of Delegates approved the final draft, Rule 1.5 required only that contingent fee arrangements be in writing.[6] Further, attorneys employed by an organization who learned of an intended violation of law by an officer or employee of

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[1] *Annual Meeting Highlights*, 29 Res Gestae 284, 285 (December 1985).

[2] Hodes, *Three Peas in a Pod*, 35 U. Miami L. Rev. 739, 745 (1981).

[3] Model Rules of Professional Conduct Rule 6.1 (Discussion Draft 1980).

[4] Model Rules of Professional Conduct Rule 6.1 (1983). [Hereinafter Model Rules].

[5] Model Rules, *supra* note 4, Rule 1.5 (Discussion Draft 1980).

[6] Model Rules, *supra* note 4, Rule 1.5.

the organization were authorized by the Discussion Draft of the Model Rules to disclose client confidences "to the extent necessary" if they were unsuccessful in seeking a suitable remedy within the organization.[7] The final version of Model Rule 1.13 calls for the resignation of organization attorneys if, after referral to the highest authority in the organization, the organization insists upon the illegal action.[8]

The Model Rules either have already replaced or are in the process of replacing the various Codes of Professional Responsibility in a majority of the states.[9] Twenty-three states have adopted a version of the ABA's Model Rules. A version of the Model Rules is currently pending before the highest courts of eleven states. Further, ten other states are currently employing study committees to review the Model Rules.[10] The Indiana Supreme Court's adoption of the Rules of Professional Conduct effective January 1, 1987,[11] ended a review process that featured lively debate over client confidentiality rules and resulted in a set of Rules that differs from the Model Rules in two areas.

The Indiana State Bar Association's Code of Conduct Study Committee reviewed the ABA's Model Rules and recommended their adoption to the Indiana State Bar Association (ISBA) House of Delegates in 1985 with only two exceptions.[12] Adopted without debate[13] was the proposal to retain Indiana's rules regarding attorney advertising.[14] The Committee's recommended revision of Model Rule 1.6 on client confidentiality, however, was much more controversial and met with resistance from the ISBA House of Delegates.[15]

The Indiana debate over Rule 1.6 began even before the Code of Conduct Study Committee submitted its proposed revision to the ISBA House of Delegates. In a 1985 article, Frederick E. Rakestraw, co-chairman of the Code of Conduct Study Committee, explained his views on the revelation of client confidences.[16] Rakestraw believed that the ABA's Model Rules did not permit attorneys enough discretion when revealing client confidences in the event that the client planned to commit

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[7]Model Rules, *supra* note 4, Rule 1.13 (Discussion Draft 1980).

[8]Model Rules, *supra* note 4, Rule 1.13.

[9]Information release from American Bar Association (May 28, 1987).

[10]*Id.*

[11]Indiana Rules of Professional Conduct (1987) [hereinafter Rules].

[12]Rakestraw, *Proposed Model Rules of Professional Conduct*, 28 Res Gestae 475, 475-76 (March 1985).

[13]*Id.*

[14]*Annual Meeting Highlights*, 29 Res Gestae 284, 285-86 (December 1985).

[15]*Id.*

[16]Rakestraw, *Proposed Model Rules of Professional Conduct*, 28 Res Gestae 475 (March 1985).

an illegal act.[17] Model Rule 1.6 allows a lawyer to reveal information pertaining to the representation of a client to the extent the lawyer believes necessary "to prevent the client from committing a criminal act . . . likely to result in imminent death or substantial bodily harm," as well as in legal proceedings between the lawyer and client and situations where the lawyer is the object of a criminal charge or civil claim based upon conduct in which the client was involved.[18] The Committee's proposed Rule 1.6 allowed a lawyer to reveal client confidences to the extent reasonably necessary "to prevent the client from committing a criminal *or fraudulent act* that the lawyer reasonably believes is likely to result in imminent death or substantial bodily harm, *or in substantial injury to the financial interests or property of another.*"[19] This amendment was designed to maintain consistency with Disciplinary Rule 7-102(B) of the Code of Professional Responsibility, which charged a lawyer with the responsibility to call upon a client to rectify a fraud perpetrated in the course of the lawyer's representation of the client and, failing that, to reveal the fraud "to the affected person or tribunal."[20]

Leon R. Kaminski and John T. Sharpnack co-authored an article in which they urged that the Code of Conduct Study Committee's proposed amendments to Model Rule 1.6 be rejected by the ISBA House Delegates.[21] Kaminski and Sharpnack expressed their fear that the Committee's proposal to expand the Model Rule's exceptions to attorney-client confidentiality would have the effect of undermining clients' confidence in attorneys and discourage clients from making full disclosure of their contemplated conduct to attorneys.[22] Kaminski and Sharpnack also shared the opinion that the more disclosure the Rules of Professional Conduct permitted, the more likely compulsory disclosure or liability for damages could be imposed upon an attorney who did not disclose information that could prevent financial injury.[23]

The ISBA House of Delegates reviewed the proposed Rules of Professional Conduct in the course of its annual meeting in October of 1985 and the amendments to Model Rule 1.6 were the only debated provisions of the Committee's proposed Rules.[24] Despite Rakestraw's

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[17]*Id.* at 476-79.

[18]Model Rules, *supra* note 4, Rule 1.6.

[19]Rakestraw, *Proposed Model Rules of Professional Conduct*, 28 Res Gestae 475, 476 (March 1985) (emphasis added).

[20]Indiana Code of Professional Responsibility DR 7-102(B) (1971) [hereinafter Code].

[21]Kaminski and Sharpnack, ". . . *to preserve inviolate the secrets of my client* . . . ." 28 Res Gestae 480 (March 1985).

[22]*Id.* at 481.

[23]*Id.* at 481-82.

[24]*Annual Meeting Highlights*, 29 Res Gestae 284, 285 (December 1985).

argument before the delegates that the Committee's amendments were necessary to prevent "a fraud to a widow and her life fortune" among other financial misdeeds, a motion to delete the Committee's amendments was approved and the proposed Rules were sent to the Indiana Supreme Court with Rule 1.6 in conformity with the ABA's Model Rules.[25]

The Rules of Professional Conduct adopted by the Indiana Supreme Court included the following provisions concerning confidentiality of information received from a client:

> (a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraph (b).
>
> (b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:
>
> (1) to prevent the client from committing any criminal act; or
>
> (2) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client.[26]

Indiana's Rule 1.6 thus differs from the ABA Model Rule 1.6 in that an Indiana attorney is permitted to reveal client confidences if it is reasonably necessary to do so in order to prevent *any* criminal act,[27] while the Model Rule 1.6 allows such disclosure only if necessary to prevent a criminal act "that the lawyer believes is likely to result in imminent death or substantial bodily harm."[28] Rule 1.6, as adopted by the Indiana Supreme Court, thus more closely resembles in its application the version of Rule 1.6 proposed by the ISBA Code of Conduct Study Committee than the version submitted by the ISBA House of Delegates.

The practical effect of Indiana's deviation from the ABA's Model Rules is that Indiana attorneys are now vested with broad discretion to reveal more client confidences regarding future criminal activity than ever before authorized by the Code of Professional Responsibility.[29] The

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[25] *Id.* at 285-86.

[26] Rules, *supra* note 11, Rule 1.6.

[27] *Id.*

[28] Model Rules, *supra* note 4, Rule 1.6.

[29] Rules, *supra* note 11, Rule 1.6. It is interesting to note that the expansion from crimes against the person to any crime would include such crimes as deception, Ind. Code § 35-46-3-2 (Supp. 1983), nonsupport of a dependent, Ind. Code § 35-42-4-3 (1982), and many federal criminal statutes such as securities fraud.

Comment accompanying Rule 1.6 provides the only limitation to the scope of the attorney's discretion by stating that "a disclosure adverse to the client's interest should be no greater than the lawyer reasonably believes necessary for the purpose."[30]

In summary, attorneys are not subject to disciplinary action for the failure to commit time or financial support to pro bono publico service; only contingent fee agreements need be in writing; attorneys employed by organizations may be required to resign if the organization's policymakers refuse to alter illegal conduct; and, attorneys in Indiana have wide latitude in disclosing client confidences to prevent any criminal act. Also noteworthy is Indiana's decision to retain its former rules on advertising rather than adopting the more relaxed standards in the Model Rules.

Besides the more prominent changes, minor adjustments of both a substantive and procedural nature have been made. With few exceptions the new Rules have streamlined the somewhat eclectic compilation of prohibitions and mandates found in their predecessor, the Code of Professional Responsibility. The most obvious nonsubstantive change in the newly adopted Rules of Professional Conduct, as compared to the former Code of Professional Responsibility, is the format. The Code was based upon nine Canons.[31] The broad statements of the Canons were further divided into Ethical Considerations and Disciplinary Rules.[32] The Ethical Considerations represented a standard of behavior desireable for lawyers, yet not mandatory.[33] The Disciplinary Rules amplified the Canons with directives which stated the minimum level of competency required of attorneys.[34] The Rules have abandoned the Canons and instead rely on eight general topic areas.[35] Despite the rejection of ethical considerations and disciplinary rules, the Rules are cast both in imperatives such as "shall" and "shall not" and in permissive terms such as "may."[36] The Comments to the Rules of Professional Conduct, which were adopted by the Indiana Supreme Court, do not carry the potential for disciplinary action even when presented in terms such as "should."[37] This article is devoted to a comparison between the former Code of Professional Responsibility and the new Rules of Professional Conduct.

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[30]RULES, *supra* note 11, Rule 1.6 comment.

[31]*See* CODE, *supra* note 20.

[32]*Id.*

[33]CODE, *supra* note 20, preliminary statement.

[34]*Id.*

[35]*See* RULES, *supra* note 11,.

[36]RULES, *supra* note 11, Scope.

[37]*Id.*

II. Discussion

A. Client-Lawyer Relationship

Sixteen rules comprise "Client-Lawyer Relationship," the first topic area in the newly adopted Rules of Professional Conduct.[38] Rule 1.1 states: "Competence: A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."[39] The accompanying Comment urges that new lawyers can be as competent as more experienced lawyers because basic to any legal undertaking is the ability to determine the legal issues involved.[40] The Comment goes on to encourage participation in continuing legal education. The Comment acknowledges that, following careful self-assessment of a lawyer's knowledge and experience, and after an assessment of the complexities of the subject matter, the lawyer may refer the matter to or consult with an attorney of established competence in the area.[41] Rule 1.1 along with its comments addresses the same topic area as Disciplinary Rule 6-101(A).[42]

Rule 1.2(a) requires attorneys to accede to clients' wishes regarding whether to settle civil actions, and in criminal cases whether to accept a plea agreement, waive jury trial or whether the client will testify.[43] The Comment instructs lawyers to consult with clients regarding all aspects of a case.[44] However, while clients determine the goals of representation, it is the attorney's responsibility, guided by professional obligations, to control the means of obtaining the clients' goals.[45] Rule 1.2 (a) has no direct parallel in the Code. However, Ethical Considerations 7-7 and 7-8, and Disciplinary Rule 7-101(A)(1) together counsel attorneys to allow clients to make decisions which depend upon "non-legal factors" while "avoiding offensive tactics."[46] Rule 1.2(a) more clearly defines the decision-making roles of attorneys and clients, than did the relevant portions of the Code.

The Comment to Rule 1.2(a) advises that if a client appears to suffer from a mental disability or is otherwise unable to aid in the

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[38]Rules, *supra* note 11, Rule 1.

[39]Rules, *supra* note 11, Rule 1.1.

[40]Rules, *supra* note 11, Rule 1.1 comment.

[41]*Id.*

[42]Code, *supra* note 20, DR 6-101(A)(1), (2).

[43]Rules, *supra* note 11, Rule 1.2(a).

[44]Rules, *supra* note 11, Rule 1.2(a) comment.

[45]*Id.*

[46]Code, *supra* note 20, EC 7-7, -8, DR 7-101(A)(1).

decision-making process, the attorney should refer to Rule 1.14.[47] Under Rule 1.14, when the lawyer perceives the client as being incapable of attending to the client's own interests, the lawyer may request the appointment of a guardian or take other measures.[48] The Comment to Rule 1.14 readily acknowledges the precarious footing upon which lawyers tread in assessing clients' varying degrees of competence.[49] Further, the Comment would impose overseer-like duties upon the lawyer, to take steps to prevent or rectify bad acts of a legal representative in accordance with Rule 1.2(d).[50] The Comment raises another complicating factor in that attorneys need to consider the adverse affects upon clients' interests if a disability is disclosed.[51] In comparison, Ethical Consideration 7-12 allowed attorneys to make decisions for impaired clients unless the client was legally required to make the decision.[52]

Rule 1.2(b) is less a rule and more in the nature of an inducement for lawyers to accept clients who are unpopular or whose cases are unsavory.[53] The Rule is self-explanatory. It provides that representation of a client "does not constitute an endorsement of the client's political, economic, social or moral views or activities."[54] This Rule has no correlative disciplinary rule in the Code.

Also without a counterpart in the Code is Rule 1.2(c) which allows an attorney to "limit the objectives of the representation if the client consents after consultation."[55] Review of its Comment suggests that Rule 1.2(c) may be directed to the rather new pre-paid legal service plans as well as attorneys who represent insureds on behalf of insurance companies.[56] Any situation where representation is limited requires full disclosure of the purpose for which the lawyer has been retained and of the extent of the limitations on representation.[57] The Comment also condemns limiting the objectives or means of representation that the "lawyer regards as repugnant or imprudent."[58] In limiting the scope of

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[47]The Comment suggests seeking the advice of a trained diagnostician. RULES, *supra* note 11, Rule 1.2(a) comment (1987). The attorney should attempt to proceed as in a normal lawyer-client relationship. *Id.*

[48]RULES, *supra* note 11, Rule 1.14.

[49]RULES, *supra* note 11, Rule 1.14 comment.

[50]*Id.*

[51]*Id.*

[52]CODE, *supra* note 20, EC 7-12.

[53]RULES, *supra* note 11, Rule 1.2(b).

[54]*Id.*

[55]RULES, *supra* note 11, Rule 1.2(c).

[56]RULES, *supra* note 11, Rule 1.2(c) comment.

[57]*Id.*

[58]*Id. See also* RULES, *supra* note 11, Rule 6.2 (appears on its face to be in contrast with the duties imposed by Rule 1.2(a), RULES, *supra* note 11, Rule 1.2(a).

representation a lawyer must be guided by the competency standards imposed by Rule 1.1.[59]

Rule 1.2(d) prohibits counseling or assisting a client in conduct that is criminal or fraudulent but does allow an attorney to counsel the client as to ramifications of proposed conduct or to explore the "validity, scope, meaning or application" of a law.[60] The Comment notes that an attorney's position is especially delicate when the client has embarked upon the illegal course of action.[61] Portions of Rule 1.2(d) echo ethical considerations and disciplinary rules found in the Code. Disciplinary Rule 7-102(A)(7) precluded counseling or assisting a client in illegal or fraudulent conduct.[62] Disciplinary Rule 7-106 prohibited advising a client to disregard an order or rule of a tribunal, but allowed a good faith challenge of the order or rule's validity.[63] A lawyer could not help create or preserve false evidence under Disciplinary Rule 7-102(A)(6).[64] Ethical Consideration 7-5 stated that "A lawyer should never encourage or aid his client to commit criminal acts or counsel his client on how to violate the law and avoid punishment thereafter."[65]

Rule 1.2(e) states "When a lawyer knows that a client expects assistance not permitted by the rules of professional conduct or other law, the lawyer shall consult with the client regarding the relevant limitations on the lawyer's conduct."[66] No comment accompanies this section: It may be difficult for an attorney to determine what the client "expects." Two disciplinary rules found in the Code address the same subject area. Disciplinary Rule 2-110(C)(1)(c) demanded withdrawal from representation when a client insisted the attorney act in an illegal manner or in a manner prohibited by the Code.[67] Any statement or implication that an attorney could improperly influence a court, legislature, or public official was forbidden by Disciplinary Rule 9-101(C).[68] In summary, Rule 1.2 embodies a broad range of concerns endemic to the client-lawyer relationship. Special attention to Rule 1.2 is warranted when an attorney is establishing the ground work for representation of a new client.

Rule 1.3 states, "A lawyer shall act with reasonable diligence and promptness in representing a client."[69] As the Comment reminds lawyers,

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[59]Rules, *supra* note 11, Rule 1.2(c) comment.

[60]Rules, *supra* note 11, Rule 1.2(a).

[61]Rules, *supra* note 11, Rule 1.2(d) comment. However, Rule 1.6 may allow disclosure. *See supra* note 26 and accompanying text.

[62]Code, *supra* note 20, DR 7-102(A)(7).

[63]Code, *supra* note 20, DR 7-106.

[64]Code, *supra* note 20, DR 7-102(A)(6).

[65]Code, *supra* note 20, EC 7-5.

[66]Rules, *supra* note 11, Rule 1.2(c).

[67]Code, *supra* note 20, DR 2-110.

[68]Code, *supra* note 20, DR 9-101(c).

[69]Rules, *supra* note 11, Rule 1.3.

"no . . . shortcoming is more widely resented than procrastination."[70] Neglect of a legal matter is the most common complaint by clients.[71] Rule 1.3 more particularly sets out the considerations that were found in Disciplinary Rules 6-101(A)(3),[72] 7-101(A)(1),[73] and 7-101(A)(3),[74] and Canon 7.[75] The prohibition against neglecting "a matter entrusted" to the lawyer found in Disciplinary Rule 6-101(A)(3) and the requirement that a lawyer "represent a client zealously within the bounds of law" prescribed in Canon 7 are most closely analogous to Rule 1.3.

Communicating with a client regarding the status of a legal matter and explaining legal considerations sufficiently to allow the client to make necessary decisions in the representation[76] form the basis of Rule 1.4.[77] The Comment recommends against full disclosure of information to clients when the client may react inappropriately as in the case of mental infirmity or when the lawyer is under court order or rule not to divulge information as required under Rule 3.4(c).[78] While the Code has no direct counterpart to Rule 1.4, Disciplinary Rule 9-102(B) required notification of the receipt of a client's funds or property.[79] Additionally, Ethical Considerations 7-8 and 9-2 urged lawyers to inform clients of relevant considerations prior to the client making decisions and to keep clients abreast of developments in their legal matters.[80]

Types of fee arrangements and the factors which should be considered when determining a fee are the subjects of Rule 1.5.[81] Rule 1.5 specifically defines perimeters that were implicit in the Code. The overriding concern regarding fees is reasonableness.[82] Also, a lawyer should consider:

> (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
>
> (2) the likelihood, if apparent to the client, that the accept-

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[70]RULES, *supra* note 11, Rule 1.3 comment.

[71]31 RES GESTAE 162 (October 1987) (statistics on complaints referred to Disciplinary Commission of the Supreme Court of Indiana).

[72]CODE, *supra* note 20, DR 6-101(A)(3).

[73]CODE, *supra* note 20, DR 7-101(A)(1).

[74]CODE, *supra* note 20, DR 7-101(A)(3).

[75]CODE, *supra* note 20, DR 7-101(A)(3).

[76]The Comment to Rule 1.4 recommends review of Rule 1.2(a) regarding client decisions, Rule 1.14 regarding mentally disabled clients, and Rule 1.13 regarding corporate clients. RULES, *supra* note 11, Rule 1.4 comment.

[77]RULES, *supra* note 11, Rule 1.4.

[78]RULES, *supra* note 11, Rule 1.4 comment.

[79]CODE, *supra* note 20, DR 9-102(B).

[80]CODE, *supra* note 20, EC 7-8, 9-2.

[81]RULES, *supra* note 11, Rule 1.5.

[82]*Id.*

ance of the particular employment will preclude other employment by the lawyer;

(3) the fee customarily charged in the locality for similar legal services;

(4) the amount involved and the results obtained;

(5) the time limitations imposed by the client or by the circumstances;

(6) the nature and length of the professional relationship with the client;

(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and

(8) whether the fee is fixed or contingent.[83]

The Comment notes that the underlying basis for a fee need not be fully disclosed to a client, but factors relied upon directly must be disclosed.[84] When initially informing a client about fees it may be sufficient to discuss with the client hourly rates, a fixed fee or an estimated fee.[85] The latter should be altered as circumstances require.[86] Disciplinary Rule 2-105(A) prohibited charging or collecting excessive or illegal fees.[87] The factors to consider when determining the amount of a fee in Rule 1.5(a) are identical to those recited in Disciplinary Rule 2-105(B).[88]

Rule 1.5(b), aimed at the representation of clients who the lawyer does not regularly represent, requires disclosure of the terms or rate of the fee prior to or soon after representation begins.[89] The Rule encourages written statements regarding fees.[90] If a fee is paid in advance, the Comment requires return of unearned portions when the lawyer-client relationship ends.[91] It may be acceptable for an attorney to receive property as payment of a fee. The attorney must be mindful of the provisions of the Rule forbidding the acquisition of a proprietary interest in the subject matter of the representation, except to the extent that a contingent fee is allowed or an attorney's lien to secure fees may be sought.[92] Although the services rendered may be commensurate with the client's ability to pay, a client should not be placed in a position of

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[83] *Id.*

[84] RULES, *supra* note 11, Rule 1.5 comment.

[85] *Id.*

[86] *Id.*

[87] CODE, *supra* note 20, DR 2-105(A).

[88] CODE, *supra* note 20, DR 2-105(B).

[89] RULES, *supra* note 11, Rule 1.5(b).

[90] RULES, *supra* note 11, Rule 1.5(b) comment.

[91] *Id.* Rule 1.16(d) requires a refund of an unearned advance payment when representation is terminated. RULES, *supra* note 11, Rule 1.16(d).

[92] RULES, *supra* note 11, Rule 1.5(b) comment.

compromising a legal matter or bargaining for further services.[93] Rule 1.5(b) more strongly advises written fee agreements than did the Code. No disciplinary rule directly embraces the concerns found in Rule 1.5(b). However, Ethical Consideration 2-19 did suggest written statements as to the fee, especially in contingent fee arrangements. If a dispute arises concerning fees, a lawyer should submit to any established procedures for resolving such disputes.[94]

Contingent fee agreements must be in writing pursuant to Rule 1.5(c).[95] The agreement must contain the method of calculating the fee, taking into consideration possible settlement, various levels of litigation and whether expenses are deducted prior to determining the contingent fee.[96] The Rule also requires a written statement of the outcome of the client's action.[97] However, Rule 1.5(d) prohibits contingent fee agreements in any matter concerning the dissolution of a marriage or in criminal cases.[98] The Comment cautions attorneys to offer alternatives to contingent fees when a contingent fee may be unsuitable.[99] In comparison, Disciplinary Rule 2-105(c) prohibited contingent fee arrangements when the lawyer represented criminal defendants.[100]

Rule 1.5(e) concerns division of fees between lawyers not associated in the same firm.[101] The following circumstances, stated in the conjunctive, must be present before division of fees should occur:

> (1) the division is in proportion to the services performed by each lawyer or, by written agreement with the client, each lawyer assumes joint responsibility for the representation;
> (2) the client is advised of and does not object to the participation of all the lawyers involved; and
> (3) the total fee is reasonable.[102]

The most significant alteration in the division of fees when compared to the Code is the provision in Rule 1.5(e)(1) allowing division of fees without regard to proportion of services if the attorneys assume joint responsibility for the representation. Because the Code made no such provision the Rule more accurately reflects lawyers' practices.

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[93] *Id.*
[94] *Id.*
[95] Rules, *supra* note 11, Rule 1.5(c).
[96] *Id.*
[97] *Id.*
[98] *Id.*
[99] Rules, *supra* note 11, Rule 1.5(d) comment.
[100] Code, *supra* note 20, DR 2-105(c).
[101] Rules, *supra* note 11, Rule 1.5(e).
[102] *Id.*

Rule 1.7 observes general conflict of interest considerations when a lawyer accepts employment.[103] A lawyer should not represent a client if doing so could negatively affect another client's interest.[104] Neither should the lawyer accept employment if another client's interests or the lawyer's personal interests could burden successful representation of the new client.[105] The Rule recognizes exceptions when the lawyer reasonably believes that no client's interests would suffer and the clients consent to the representation.[106] If a lawyer represents multiple clients in a single transaction, the lawyer must disclose the negative and positive implications of joint representation.[107] The overriding principle is client loyalty.[108]

The Comment narrows the potential for a conflict to those situations where the clients' interests are directly affected.[109] Consequently, no conflict requiring disclosure would necessarily arise when a lawyer undertakes representation of two clients with competing pecuniary interests when the representation does not involve related matters.[110] The Code contained similar provisions in Disciplinary Rule 5-101(A) and Disciplinary Rule 5-105(A). The former prohibited representation of a client absent full disclosure if the lawyer's interest could conflict with those of the client. The latter required rejection of employment if the proposed employment could interfere with the lawyer's professional independent judgment on behalf of another client.[111]

The Comment to Rule 1.7 stresses the potential for conflict when multiple representation of criminal defendants is undertaken. Because criminal defendants often have competing interests, normally such representation should be avoided.[112] However, in either civil or criminal cases a lawyer may represent multiple clients if their interests are comparable and the potential for negative consequences is minimal.[113] The Comment refers to Rule 2.2, which allows an attorney to act as an intermediary between clients in establishing or adjusting an entrepreneurial relationship.[114] As in any other joint representation, the lawyer must

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[103]Rules, *supra* note 11, Rule 1.7.

[104]*Id.*

[105]*Id.*

[106]*Id.*

[107]*Id.*

[108]*Id.*

[109]Rules, *supra* note 11, Rule 1.7 comment.

[110]*Id.* Interestingly, the Comment suggests that a conflict may arise when an attorney asserts opposing positions on the same legal issue in different matters pending in a trial court. Yet, the Comment condemns as improper the assertion of differing positions in independent matters pending before an appellate court. *Id.*

[111]Code, *supra* note 20, DR 5-101(A), 105(A).

[112]Rules, *supra* note 11, Rule 1.7 comment.

[113]*Id.*

[114]Rules, *supra* note 11, Rule 2.2.

assess the possibility that a client's interests will be damaged and must reasonably conclude that the matter will be resolved in each client's best interest.[115] Moreover, if a mutually acceptable resolution is not forthcoming, the attorney must withdraw from the representation and discontinue representation of any of the clients regarding the subject matter.[116] The Comment to Rule 2.2 is somewhat contradictory in that it states that multiple representation situations should not diminish the rights of each client in the lawyer-client relationship.[117] Yet, the Comment recognizes that usually the attorney-client privilege does not exist between commonly represented clients.[118] Accordingly, the Comment opines that in the eventuality of litigation between clients, the privilege will not protect the communications, and clients should be so advised.[119] Joint representation of clients and especially the situation where the lawyer acts as an intermediary requires great sensitivity by the lawyer to all clients' needs and to the potential for deterioration of the representation.[120]

With regard to multiple clients, Disciplinary Rule 5-105[121] in the Code allowed such representation when each client consented after being informed of possible consequences.[122] If the lawyer's independent professional judgment could be negatively affected, requiring withdrawal or refusal of employment, the lawyer's partners, associates and firm were also disqualified.[123] Also included in the Comment to Rule 1.7 is a concern raised in Disciplinary Rule 5-107(B) of the Code.[124] When a person or organization other than the client is responsible for the lawyer's fee, the lawyer must ensure proper representation without interference from the outside source.[125] The Comment requires disclosure to and the consent of the client prior to representation, whereas the Disciplinary Rule did not.[126] Rule 1.8(f) expresses the same consideration in the form of a Rule.[127]

Rule 1.8 outlines specific transactions that would constitute a conflict of interest.[128] The version of Rule 1.8 adopted in the Model Rules

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[115] *Id.*
[116] *Id.*
[117] RULES, *supra* note 11, Rule 2.2 comment.
[118] *Id.*
[119] *Id.*
[120] *Id.*
[121] CODE, *supra* note 20, DR 5-105(B), (C), (D).
[122] *Id.*
[123] RULES, *supra* note 11, Rule 1.7 comment.
[124] CODE, *supra* note 20, DR 5-107(B).
[125] RULES, *supra* note 11, Rule 1.7 comment.
[126] *Id.*
[127] RULES, *supra* note 11, Rule 1.8(f).
[128] RULES, *supra* note 11, Rule 1.8.

contained ten parts.[129] On September 4, 1987, the Indiana Supreme Court added an eleventh section, Rule 1.8(k),[130] defining and limiting the type of civil practice proper for part-time prosecutors.[131]

Rule 1.8(a) forbids business transactions with clients or business interests adverse to a client unless three conditions are met.[132] The lawyer must acquire only a fair and reasonable interest which is disclosed to the client in writing; the client must be given an opportunity to consult with other counsel; and the client must consent in writing.[133] Similar concerns were expressed in Disciplinary Rule 5-104(A)[134] along with Ethical Consideration 5-3.[135]

Rule 1.8(b) is unambiguous and has a direct counterpart in the Code. The new Rule prohibits the use of information gained from representation of a client to the client's disadvantage unless the client consents.[136] Disciplinary Rule 4-101(B) provided that an attorney could neither use confidences of the client to the client's disadvantage nor use confidences for the advantage of another without the client's consent.[137]

Rule 1.8(c) precludes the preparation of an instrument for a client wherein the lawyer or a relative of the lawyer receives a substantial gift "including a testamentary gift, except where the client is related to the donee."[138] No complementary disciplinary rule appeared in the Code, although Ethical Consideration 5-5 expressed similar prohibitions.

"Prior to the conclusion of representation of a client," a lawyer must not "make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account" relating to the subject of the representation is the teaching of Rule 1.8(d).[139] The Comment excludes from the Rule a fee comprised of a share in literary property if the fee comports with Rule 1.5.[140] The Code contained Disciplinary Rule 5-104(B) which effected the same goal.[141]

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[129]Model Rules, *supra* note 4, Rule 1.8.

[130]Rules, *supra* note 11, Rule 1.8(k).

[131]Rules, *supra* note 11, Rule 1.8(k). *See also* Code, *supra* note 20, EC 5-14 to -20.

[132]Rules, *supra* note 11, Rule 1.8(a).

[133]*Id.*

[134]Code, *supra* note 20, DR 5-104(A).

[135]Code, *supra* note 20, EC 5-3.

[136]Rules, *supra* note 11, Rule 1.8(b). It is difficult to perceive how an attorney can competently represent a client while determining whether the client will allow the attorney to reveal confidences to the client's disadvantage.

[137]Code, *supra* note 20, DR 4-101(B)(2)(3).

[138]Rules, *supra* note 11, Rule 1.8(c).

[139]Rules, *supra* note 11, Rule 1.8(d).

[140]Rules, *supra* note 11, Rule 1.8(d) comment.

[141]Code, *supra* note 20, DR 5-104(B).

The Rules relax the Code's mandate that a lawyer not advance any costs or expenses of litigation for which the client was not ultimately responsible.[142] According to Rule 1.8(c) a lawyer still cannot render financial assistance to a client, yet the lawyer may advance costs and expenses of litigation with repayment contingent upon a recovery.[143] Also, the Rule allows an attorney to pay litigation expenses without the expectation of repayment if the client is indigent.[144] The new Rule recognizes, to some extent, the relative financial disparity between many plaintiffs and defendants. The Rule stops short of allowing attorneys to provide subsistence funds to clients who have been injured or disabled and who are faced with a lengthy litigation process.[145]

Agreements to limit lawyers' liability for malpractice are prohibited in Rule 1.8(h), except when in compliance with applicable laws and when the client has obtained independent counsel.[146] Further, a lawyer cannot settle a malpractice action without advising the client or former client in writing that the client should consult another lawyer regarding the claim.[147] The Code provision most closely aligned with Rule 1.8(h) is Disciplinary Rule 6-102(A).[148]

Rule 1.8(i) disqualifies related attorneys from representing different clients on opposing sides of a controversy, unless the clients consent.[149] The Comment notes that the disqualification attaches to the related lawyers rather than members of their law firms.[150] A similar rule appeared in the Code.[151]

Rule 1.8(j) prohibiting a lawyer from obtaining an interest in the subject matter of a client's representation should be read in conjunction with Rule 1.5 and its Comments. Rule 1.8(j) specifically excludes lawyers liens for fees and contingent fee matters as noted in the Comment to Rule 1.5.

The addition of Rule 1.8(k) to Indiana's Rules of Professional Conduct represents a departure from the Model Rules. The Rule states:

> (k) A part-time prosecutor or deputy prosecutor authorized by statute to otherwise engage in the practice of law shall refrain

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[142] *See* CODE, *supra* note 20, DR 5-103(B).

[143] RULES, *supra* note 11, Rule 1.8(e).

[144] *Id.*

[145] This measure was debated in the House of Delegates.

[146] RULES, *supra* note 11, Rule 1.8(h).

[147] *Id.*

[148] *See* CODE, *supra* note 20, DR 6-102(A).

[149] RULES, *supra* note 11, Rule 1.8(i).

[150] RULES, *supra* note 11, Rule 1.8(i) comment. The Rule presupposes that the lawyers are associated with different firms. *Id.*

[151] CODE, *supra* note 20, DR 5-101(A).

> from representing a private client in any matter wherein exists an issue upon which said prosecutor has statutory prosecutorial authority or responsibilities. This restriction is not intended to prohibit representation in tort cases in which investigation and any prosecution of infractions has terminated, nor to prohibit representation in family law matters involving no issue subject to prosecutorial authority or responsibilities. Upon a prior, express written limitation of responsibility to exclude prosecutorial authority in matters related to family law, a part-time deputy prosecutor may fully represent private clients in cases involving family law.[152]

The various sections of Rule 1.8 are largely as applicable to ongoing representation of a client as they are to employment by a new client. Indiana's Rule 1.8(k) clarifies the type of private practice available to part-time or deputy prosecutors.

After a lawyer has represented a client in a legal matter, Rule 1.9(a) mandates the refusal of employment in a related matter if a new client's interests are opposed to those of the former client, unless the lawyer obtains the permission of the former client.[153] The Rule is not intended to deter representation of a new client in a position adverse to that taken for a former client on a matter not related to the former client's representation.[154] As in many situations arising from the rules, an attorney may be able to extricate himself/herself from potential problems by disclosing the circumstances to the client and obtaining the client's permission to proceed.

Rule 1.9(b) prohibits the "use of information relating to the representation to the disadvantage of the former client except as Rule 1.6 would permit with respect to a client or when information has become generally known."[155] This provision is substantially similar to Rule 1.8(b). Rule 1.8(b) refers to information of a current client[156] while Rule 1.9(b) refers to a former client.[157] Rule 1.9 has no representation in the disciplinary rules of the Code. Similar concerns were addressed through Ethical Consideration 4-6 which encouraged the preservation of a former client's "confidences and secrets."[158]

Rule 1.10 logically expands the conflict of interest disqualifications for attorneys found in Rules 1.7, 1.8 and 1.9 to the attorneys in law

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[152] RULES, *supra* note 11, Rule 1.8(k).
[153] RULES, *supra* note 11, Rule 1.9(a).
[154] *But see supra* note 110 and accompanying text.
[155] RULES, *supra* note 11, Rule 1.9(b).
[156] RULES, *supra* note 11, Rule 1.8(b).
[157] RULES, *supra* note 11, Rule 1.9(b).
[158] CODE, *supra* note 20, EC 4-6.

firms associated with the attorneys who would be disqualified.[159] In the case of a lawyer extinguishing association with a firm, attorneys in the firm are not necessarily disqualified from employment by a client whose interests are adverse to those of a client represented by the formerly associated lawyer.[160] However, if the matter of the representation "is the same or substantially related to that in which the formerly associated lawyer represented the client; and . . . any lawyer remaining in the firm has information protected by Rules 1.6 and 1.9(b) that is material to the matter" a disqualification may be appropriate.[161] As often provided in the Rules, a lawyer or the firm[162] may not be required to refuse employment if the client who would be adversely affected waives the protection.[163] This question of disqualification was minimally addressed in Disciplinary Rule 5-105(D).[164] It required law firms to withdraw or refuse employment in a matter in which an attorney associated with the firm was disqualified.[165]

Aimed at curbing the exploitation of governmental or public service employment for the advantage of a private client, Rules 1.11(a) and (b) limit the participation by lawyers or their firms in matters for private clients if the lawyers personally acted in the matter while employed by a government agency.[166] The disqualification may be relaxed if the government agency consents to the representation after disclosure.[167] The Code counterpart to Rule 1.11(a), Disciplinary Rule 9-101(B), stated "A lawyer shall not accept private employment in a matter in which he had substantial responsibility while he was a public employee."[168]

In the cases where government employment succeeds private employment or a government employee considers pursuit of private employment, Rule 1.11(c) controls.[169] Rule 1.11(c)(1) precludes participation by a public employee "in a matter in which the lawyer participated personally and substantially while in private practice or nongovernmental employment, unless under applicable law no one is, or by lawful del-

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[159] RULES, *supra* note 11, Rule 1.10.

[160] *Id.*

[161] *Id.*

[162] As to what type of group constitutes a "firm," the Comment specifically includes private law firms, corporate counsel within the same entity and legal services organizations. RULES, *supra* note 11, Rule 1.10 comment. Less obvious are cases where attorneys share office space, unincorporated organizations with affiliates and some governmental units.

[163] RULES, *supra* note 11, Rule 1.10.

[164] CODE, *supra* note 20, DR 5-105(D).

[165] *Id.*

[166] RULES, *supra* note 11, Rule 1.11(a), (b).

[167] *Id.*

[168] CODE, *supra* note 20, DR 9-101(B).

[169] RULES, *supra* note 11, Rule 1.11(c).

egation may be, authorized to act in the lawyer's stead in the matter."[170] In the second portion of the Rule, 1.11(c)(2), an attorney in public service is prohibited from negotiating private employment with an attorney or a person involved in a matter in which the government attorney is involved.[171] The Comment accompanying Rule 1.11(c) notes that the section is directed to the lawyer personally involved, not other lawyers in the same public or governmental agency.[172] The Code contained no counterpart to this Rule.[173]

Rule 1.12 corresponds to Rule 1.11(c), but substitutes a judicial officer, an arbitrator or a law clerk to a judicial officer for the lawyer employed by a governmental agency.[174] The Comment includes within the term "adjudicative officer" judges pro tempore, referees, special masters, hearing officers, parajudicial officers, and part-time judges.[175] The law firm of any disqualified lawyer is also disqualified with few exceptions.[176] Although a judicial officer may not solicit employment with a party or lawyer in a matter in which the judge is actually participating, a law clerk may do so, after notifying the adjudicative officer by whom the law clerk is employed.[177] Also "an arbitrator selected as a partisan of a party in a multi-member arbitration panel is not prohibited from subsequently representing that party."[178] In the Code Disciplinary Rule 9-101(A) forbade representation of a client in a matter in which the lawyer served in an adjudicative capacity on the merits.[179] Other portions of Rule 1.12 have no corresponding disciplinary rule in the Code. However, the Code of Judicial Conduct Canon 3 carries substantially similar import.[180]

The special considerations necessary when an attorney is employed by a corporate client or organization are the subject of Rule 1.13.[181] The attorney conducts the representation through "duly authorized constituents" of the organization.[182] A communication by a constituent regarding the organization is protected by Rule 1.6. As noted in the

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[170]Rules, *supra* note 11, Rule 1.11(c)(1).

[171]Rules, *supra* note 11, Rule 1.11(c)(2).

[172]Rules, *supra* note 11, Rule 1.11 comment.

[173]*Id.*

[174]Rules, *supra* note 11, Rule 1.12.

[175]Rules, *supra* note 11, Rule 1.12 comment.

[176]Rules, *supra* note 11, Rule 1.12.

[177]Rules, *supra* note 11, Rule 1.12.

[178]Rules, *supra* note 11, Rule 1.12 comment.

[179]Code, *supra* note 20, DR 9-101(A).

[180]Code of Judicial Conduct Canon 3(C)(1)(b)-(d).

[181]Rules, *supra* note 11, Rule 1.13.

[182]*Id.* The Comment defines constituents as "positions equivalent to officers, directors, employees, and shareholders." Rules, *supra* note 11, Rule 1.13 comment.

introduction, provisions in Rule 1.13 mandate some attempt at curative action by the attorney when a constituent contemplates the refusal to act or action in a manner repugnant to a legal obligation or in violation of the law.[183] After assessing the risk to the organization and the best course of conduct, a lawyer may take such measures as:

> (1) asking reconsideration of the matter;
> (2) advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and
> (3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.[184]

At least two ethical considerations within the Code are applicable to Rule 1.13; however, the topic was not treated by the Code's disciplinary rules. Canon 5 in the Code stated, "A Lawyer Should Exercise Independent Professional Judgment on Behalf of a Client."[185] In accordance with the Canon directive, Ethical Consideration 5-18 advised a lawyer employed by an organization that the entity and not the persons connected to the organization should be the focus of the lawyer's loyalty and attention.[186] In connection with a lawyer's exercise of independent professional judgment, Ethical Consideration 5-24 cautioned lawyers employed by corporations which necessarily depend upon officers and directors for business direction to decline interference from laymen when exercising professional judgment.[187] In general the new rules on conflict of interest, Rule 1.7 through Rule 1.13, provide more detailed factors and guidelines for successful resolution of such issues than did the Code.

Rule 1.15 on the safekeeping of property compares favorably with the Code's Disciplinary Rule 9-102. Both the new and old rules require maintenance of separate accounts for the lawyer's fund, prompt notification to a party of the receipt of property or funds by the lawyer, separation of amounts in dispute such as the lawyer's fee and complete records regarding property and funds.[188] Rule 1.15 extends the considerations beyond clients to also include third parties.[189] Also, Rule 1.15

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[183] *See supra* notes 7-8 and accompanying text.
[184] RULES, *supra* note 11, Rule 1.13.
[185] CODE, *supra* note 20, Canon 5.
[186] CODE, *supra* note 20, EC 5-18.
[187] CODE, *supra* note 20, EC 5-24.
[188] RULES, *supra* note 11, Rule 1.15; CODE, *supra* note 20, DR 9-102.
[189] RULES, *supra* note 11, Rule 1.15.

requires retention of records concerning funds and property for a period of five years after representation.[190]

The final portion of Rule 1 is Rule 1.16 regarding the refusal of or withdrawal from representation. The Rule mandates the refusal of employment or withdrawal[191] if:

> (1) the representation will result in violation of the rules of professional conduct or other law;
> (2) the lawyer's physical or mental condition materially impairs the lawyer's ability to represent the client; or
> (3) the lawyer is discharged.[192]

Rule 1.16(b) reminds lawyers in situations in which the lawyer wishes to withdraw from representation that decisions should be tempered by a determination of whether withdrawal would negatively affect the interests of the client.[193] The Rule goes on to recite factors which could instigate withdrawal, apparently without regard to an adverse impact on the client's interests.[194] These factors include the following:

> (1) the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent;
> (2) the client has used the lawyer's services to perpetrate a crime or fraud;
> (3) a client insists upon pursuing an objective that the lawyer considers repugnant or imprudent;
> (4) the client fails substantially to fulfill an obligation to the lawyer regarding the lawyer's services and has been given reasonable warning that the lawyer will withdraw unless the obligation is fulfilled;
> (5) the representation will result in an unreasonable financial burden on the lawyer or has been rendered unreasonably difficult by the client; or
> (6) other good cause for withdrawal exists.[195]

Rule 1.16(d) insists that a lawyer who is withdrawing from employment protect the client's interests to the degree possible.[196] The lawyer

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[190] *Id.*

[191] Rule 1.16(c) notes that a lawyer may not be able to withdraw if ordered by a tribunal to continue representation. RULES, *supra* note 11 Rule 1.16(c).

[192] RULES, *supra* note 11, Rule 1.16.

[193] RULES, *supra* note 11, Rule 1.16(b).

[194] *Id.*

[195] *Id.*

[196] RULES, *supra* note 11, Rule 1.16(d).

should consider temporal limitations on the client's ability to engage different counsel, return of the client's property, papers and funds including any unearned fee advanced by the client.[197] The Comment warns that retention of papers until payment of fee is permitted only to the extent recognized by law.[198] This rule correlates with Disciplinary Rule 2-109 in the Code, which addresses many of the same concerns.[199]

B. The Attorney as a Counselor

Rule 2 addresses the attorney's role as a counselor. Rule 2.1 states: "In representing a client, a lawyer shall exercise independent professional judgment and render candid advice. In rendering advice, a lawyer may refer not only to law but to other considerations such as moral, economic, social and political factors, that may be relevant to the client's situation."[200] Rule 2.1 embodies much of the impact of Ethical Consideration 7-8 in the Code.[201] However, Ethical Consideration 7-8 specified that nonlegal considerations influencing legal objectives should be ultimately determined by the court.[202]

Lawyers in public or private practice are occasionally called upon to render an opinion on a matter concerning a client. Rule 2.3 states:

> (a) A lawyer may undertake an evaluation of a matter affecting a client for the use of someone other than the client if:
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> (1) the lawyer reasonably believes that making the evaluation is compatible with other aspects of the lawyer's relationship with the client; and
>
> (2) the client consents after consultation.
>
> (b) Except as disclosure is required in connection with a report of an evaluation, information relating to the evaluation is otherwise protected by Rule 1.6.[203]

Pursuant to the Comment, this Rule is not intended to encompass an investigation or evaluation of matters regarding a person who is not a client.[204] The Code contained no counterpart to Rule 2.3.

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[197] *Id.*

[198] RULES, *supra* note 11, Rule 1.16(d) comment. Lawyers who retain client's funds after withdrawal or discharge in order to secure payment of the lawyer's fee should consult Rule 1.5 and Rule 1.8(g).

[199] CODE, *supra* note 20, DR 2-109.

[200] RULES, *supra* note 11, Rule 2.1.

[201] CODE, *supra* note 20, EC 7-8.

[202] *Id.*

[203] RULES, *supra* note 11, Rule 2.3.

[204] RULES, *supra* note 11, Rule 2.3 comment.

C. The Attorney as an Advocate

Rule 3 purports to govern the lawyer in his or her role as an "Advocate."[205] Attorneys are charged with the duty to assert only meritorious claims and contentions, to expedite litigation, to act with complete concern toward the tribunal, to be fair to opposing party and counsel and to respect the impartiality and decorum of the tribunal.[206] Rule 3 also covers the lawyer's role in trial publicity and as a witness and sets out the responsibilities of a lawyer acting as a prosecutor or an advocate in nonadjudicative proceedings.[207]

Rule 3.1, entitled "Meritorious Claims and Contentions," limits a lawyer to asserting claims and contentions that are "not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law."[208] The Comment accompanying the Rule states that a claim may not be "frivolous" even if the lawyer does not believe that the client's argument will prevail, but a claim is frivolous if it is asserted "primarily for the purpose of harassing or maliciously injuring a person."[209] Rule 3.1 extends to defense counsel in a criminal proceeding freedom to "defend the proceeding so as to require that every element of the case be established," regardless of any other requirements contained in Rule 3.1.[210] Similarly, Disciplinary Rule 7-102(A) prohibited both the filing of a suit merely to harass and the assertion of a nonmeritorious claim and employed nearly the identical language used by Rule 3.1 to prohibit these actions.[211] Rule 3.1 omits Disciplinary Rule 7-102(A)(1)'s qualifier, "when he (the lawyer) knows or when it is obvious that such action would serve merely to harass or maliciously injure another,"[212] which changes the scrutiny of lawyer conduct in filing allegedly harassing claims from a subjective test of the lawyer's knowledge to an objective test.

Rule 3.2 charges a lawyer with the duty to "make reasonable efforts to expedite litigation consistent with the interests of his client."[213] The Comment accompanying the Rule focuses on the discouragement of delays solely for the purposes of the lawyer's convenience, benefit or the frustration of the opponent.[214] Further, the Comment articulates a

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[205]RULES, *supra* note 11, Rule 3.

[206]*Id.*

[207]*Id.*

[208]RULES, *supra* note 11, Rule 3.1.

[209]RULES, *supra* note 11, Rule 3.1 comment.

[210]RULES, *supra* note 11, Rule 3.1.

[211]CODE, *supra* note 20, DR 7-102(A).

[212]RULES, *supra* note 11, Rule 3.1.

[213]RULES, *supra* note 11, Rule 3.2.

[214]RULES, *supra* note 11, Rule 3.2 comments.

test for unreasonable delay—"whether a competent lawyer acting in good faith would regard the course of action as having some substantial purpose other than delay."[215] The Comments accompanying Rule 3.2 prohibit the same lawyer activity that Disciplinary Rule 7-102(A)(1) prohibited.[216] However, as in Rule 3.1, the Code requirement that a lawyer have actual knowledge of the destructive effect of his or her deleterious actions is eliminated. Perhaps the reasoning behind this strengthening of the proscription against delay can be found in the Comment's express concern that "delaying practices bring the administration of justice into disrepute."[217]

Rule 3.3, entitled "Candor Toward the Tribunal," prohibits a lawyer from knowingly making a false statement of material fact to a tribunal or concealing adverse material facts of legal authority from the tribunal.[218] Rule 3.3 also charges a lawyer with the duty to inform the tribunal of all adverse and favorable material facts in an ex parte proceeding.[219] The Comments accompanying Rule 3.3 focus chiefly on the duties of a lawyer who is presented with false evidence or testimony in favor of his or her client's case. While Rule 3.3(c) gives the lawyer discretion, rather than a duty, to refuse to offer evidence the lawyer believes is false,[220] the Comments set out three different criteria for a lawyer's actions when a nonclient, a civil client and a criminal defendant client offer evidence the lawyer knows to be false. If the false evidence is offered by a nonclient, the Comments are clear—"the lawyer must refuse to offer it regardless of the client's wishes."[221] If the false evidence is provided by a civil client and the lawyer fails to persuade the client not to offer the false evidence, the lawyer must disclose the deception to the court and/or the opposing party.[222] If the false evidence is provided by a criminal defendant, and the lawyer cannot persuade the client not to offer the evidence, the Comments set out the following sequence that should be followed:

> If perjured testimony or false evidence has been offered, the advocate's proper course ordinarily is to remonstrate with the client confidentially. If that fails, the advocate should seek to withdraw if that will remedy the situation. If withdrawal will not remedy the situation or is impossible, the advocate should

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[215] *Id.*

[216] CODE, *supra* note 20, DR 7-102(A)(1).

[217] RULES, *supra* note 11, Rule 3.2 comments.

[218] RULES, *supra* note 11, Rule 3.3.

[219] *Id.*

[220] *Id.*

[221] RULES, *supra* note 11, Rule 3.3 comments.

[222] *Id.*

> make disclosure to the court. It is for the court then to determine what should be done—making a statement about the matter to the trier of fact, ordering a mistrial or perhaps nothing.[223]

The Comments acknowledge the potential harm these actions may have to a criminal defendant and the probability of a mistrial, but state that these measures are justified by the need to prevent a lawyer from perpetrating a fraud on the court.[224]

Rule 3.3 does not deviate significantly from the provisions of the Code which prohibit a lawyer from knowingly using perjured testimony or false evidence,[225] requires a lawyer to disclose knowledge of a fraud on the tribunal,[226] prohibits lawyers from failing to disclose adverse facts or precedent,[227] and prohibits lawyers from making false statements of law and fact.[228] The requirement of full disclosure in an ex parte proceeding has no counterpart in the Code.

Rule 3.4, which is entitled "Fairness to Opposing Party and Counsel," prohibits a lawyer from obstructing the pre-trial discovery process, participating in falsifying evidence or asserting personal knowledge of facts at a trial while acting as counsel.[229] The provisions of Rule 3.4 appear to be little more than an elaboration on Rule 3.3, since acts such as those listed above would constitute a violation of a lawyer's duty of candor toward the tribunal. The Comments point out that falsification or destruction of evidence is usually a criminal offense.[230] The Comments cite the common law rule that prohibits payment of any fee to an occurrence witness or a contingent fee to an expert witness.[231] Rule 3.4 borrows most of its provisions from Disciplinary Rules 7-106 and 7-107, which governed "Trial Conduct"[232] and "Contact with Witness"[233] respectively.

"Impartiality and Decorum of the Tribunal" is the subject of Rule 3.5, which proscribes ex parte communication and improper influence

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[223] *Id.* The Comment admits that similar actions by a criminal defense attorney have been construed to be unconstitutional violations of due process rights and right to counsel in some jurisdictions. The Comment then points out the obvious fact that the Rules are subordinate to constitutional requirements when the courts find that the two conflict. *Id.*

[224] *Id.*

[225] CODE, *supra* note 20, DR 7-102(A)(4).

[226] CODE, *supra* note 20, DR 7-102(B)(1).

[227] CODE, *supra* note 20, DR 7-102(A)(3).

[228] CODE, *supra* note 20, DR 7-102(A)(5).

[229] RULES, *supra* note 11, Rule 3.4.

[230] RULES, *supra* note 11, Rule 3.4 comments.

[231] *Id.*

[232] CODE, *supra* note 20, DR 7-106.

[233] CODE, *supra* note 20, DR 7-107.

of a judge, juror or prospective juror.[234] Rule 3.5(c) contains a "mind your manners" requirement for a lawyer who is practicing before a tribunal,[235] and the Comments outline a lawyer's duties when faced with "abuse" from a tribunal:

> A lawyer may stand firm against abuse by a judge but should avoid reciprocation; the judge's default is no justification for similar dereliction by an advocate. An advocate can present the cause, protect the record for subsequent review and preserve professional integrity by patient firmness no less effectively than by belligerence or theatrics.[236]

The effect of Rule 3.5 is identical to that of Disciplinary Rules 7-108,[237] 7-109(C)[238] and 7-106(C)(6).[239]

Rule 3.6 outlines the lawyer's role in distributing information in connection with "Trial Publicity."[240] Rule 3.6(a) charges the lawyer with a general duty to avoid making public statements the lawyer "knows or reasonably should know" will prejudice a legal proceeding.[241] Rule 3.6(b) lists some of the subjects which are forbidden: criminal record of a party, guilty plea possibilities, physical evidence characteristics, opinions on guilt or innocence and any comments regarding evidence which is likely to be ruled inadmissible.[242] Rule 3.6(c) lists in detail what a lawyer may comment on, including public record information, results of any steps in the litigation and warnings of danger if necessary.[243] The provisions of Rule 3.6 are nearly identical to those contained in Disciplinary Rule 7-107,[244] the lone exception being that Rule 3.6 for the first time prohibits lawyer statements regarding the nature of seized physical evidence.[245]

Rule 3.7 generally prohibits a lawyer from acting as an advocate in a trial where the lawyer will be a witness, but also lists exceptions such

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[234] RULES, *supra* note 11, Rule 3.5. The Comment accompanying Rule 3.5 refers the lawyer to the criminal code and the ABA Model Code of Judicial Conduct in order to be familiar with what conduct amounts to "improper influence." RULES, *supra* note 11, Rule 3.5 comment.

[235] RULES, *supra* note 11, Rule 3.5.

[236] RULES, *supra* note 11, Rule 3.5 comments.

[237] CODE, *supra* note 20, DR 7-108(A)(B).

[238] CODE, *supra* note 20, DR 7-109(C).

[239] CODE, *supra* note 20, DR 7-106(C)(6).

[240] RULES, *supra* note 11, Rule 3.6.

[241] *Id.*

[242] *Id.*

[243] *Id.*

[244] CODE, *supra* note 20, DR 7-107.

[245] RULES, *supra* note 11, Rule 3.6.

as testimony relating to an uncontested issue, testimony relating to the legal services provided in the case or the seemingly broad category of instances when disqualification of the lawyer would cause "substantial" hardship to the client.[246] A balancing of prejudices is inevitable in the event of the last exception. The client's hardship must be weighed against the likely prejudice caused to the opposing party due to the lawyer's testimony. Though the Comments recognize this dilemma,[247] they give no guidance as to who should have the job of deciding which interest is more vital. The Rule and Comments do not mention whether the lawyer should decide this question or present the dilemma to the trial judge for a ruling. In discussing whether a lawyer can testify in a case where another lawyer in the same firm is an advocate, the Comments note that it is the lawyer's responsibility to decide whether a conflict exists.[248] Rule 3.7 does not deviate significantly from the terms of Disciplinary Rules 5-101(B)[249] and 5-102,[250] its Code counterparts.

Rule 3.8 governs the "Special Responsibility of a Prosecutor,"[251] and in light of the Comments' description of the prosecutor's role as a "minister of justice,"[252] this Rule charges the prosecutor with a duty to protect the constitutional rights of the criminal defendant.[253] Rule 3.8's provisions calling for a prosecutor to bring only charges supported by probable cause and to disclose to the defense all relevant information regarding the case[254] were contained in Disciplinary Rule 7-103.[255] However, Rule 3.8 goes further than Disciplinary Rule 7-103 in that a prosecutor is now proscribed from obtaining a waiver of rights from an unrepresented client at a pre-trial hearing,[256] and personnel assisting in the prosecution of a case are prevented from making any extra-judicial statements that Rule 3.6 would prevent the prosecutor from making.[257]

Rule 3.9, entitled "Advocate in Nonadjudicative Proceedings," simply requires a lawyer who is representing a client before a legislative or administrative tribunal to comply with Rules 3.3(a)-(c), 3.4(a)-(c), and

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[246] RULES, *supra* note 11, Rule 3.7.
[247] RULES, *supra* note 11, Rule 3.7 comments.
[248] *Id.*
[249] CODE, *supra* note 20, DR 5-101(B).
[250] CODE, *supra* note 20, DR 5-102.
[251] RULES, *supra* note 11, Rule 3.8.
[252] RULES, *supra* note 11, Rule 3.8 comments.
[253] RULES, *supra* note 11, Rule 3.8.
[254] *Id.*
[255] CODE, *supra* note 20, DR 7-103.
[256] RULES, *supra* note 11, Rule 3.8.
[257] *Id.*

Rule 3.5.[258] Rule 3.9 makes mandatory the behavior recommended by Ethical Considerations 7-15,[259] 7-16[260] and 8-5.[261]

D. Attorney Conduct Toward Nonclients

When a lawyer's representation of a client touches upon the interests of persons who are not clients, Rule 4.1 through Rule 4.4 should be consulted. Rule 4.1 cautions that attorneys can neither make false statements to a third person nor decline to reveal information to a third person "necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6."[262] The Code contained similar statements in Disciplinary Rule 7-102(A)(5).[263]

Rules 4.2 and 4.3 outline considerations for an attorney who communicates with a party or person about the subject of the representation. Rule 4.2 precludes discussion of the legal matter with a party who is represented by counsel absent the consent of a person's lawyer, unless the communication is authorized by law.[264] The Rule is almost identical to Disciplinary Rule 7-104(A)(1).[265] Rule 4.3 prohibits the statement or implication that the lawyer is a detached expert on law, when the lawyer is communicating with an unrepresented person.[266] If the lawyer realizes that the unrepresented person misapprehends the lawyer's role, the lawyer must attempt to clarify the misunderstanding.[267] The Comment warns against offering advice to an unrepresented person, except to advise the person to seek counsel.[268] Rule 4.3 coupled with its Comment imparts responsibilities similar to those in Disciplinary Rule 7-104(A)(2).[269]

Rule 4.4 is a catch-all rule for the proper course of conduct concerning third persons. The rule states: "In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person, or use methods of obtaining evidence that violate the legal rights of such a person."[270] Several disciplinary rules in the Code would relate to Rule 4.4. Disciplinary Rules

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[258]RULES, *supra* note 11, Rule 3.9.
[259]CODE, *supra* note 20, EC 7-15.
[260]CODE, *supra* note 20, EC 7-16.
[261]CODE, *supra* note 20, EC 8-5.
[262]RULES, *supra* note 11, Rule 4.1.
[263]CODE, *supra* note 20, DR 7-102(A)(3)(5).
[264]RULES, *supra* note 11, Rule 4.2.
[265]CODE, *supra* note 20, DR 7-104(A)(1).
[266]RULES, *supra* note 11, Rule 4.3.
[267]*Id.*
[268]RULES, *supra* note 11, Rule 4.3 comment.
[269]CODE, *supra* note 20, DR 7-104(A)(2).
[270]RULES, *supra* note 11, Rule 4.4.

7-106(C)(2), 7-102(A)(1), 7-108(D) and 7-108(E) prohibited actions, questions, and investigations which were calculated to harass, injure or degrade third persons.[271]

E. The Attorney in an Organization

Questions of professional ethics unique to law firms and associations are the focus of Rule 5. Rule 5.1 defines the duties of a supervisory lawyer or partner in a firm to oversee the professional conduct of other lawyers in the firm.[272] Rule 5.1(a) charges partners with the responsibility for reasonably ensuring conformity with the Rules by all lawyers in the firm.[273] Similarly, Rule 5.1(b) specifically directs lawyers in a supervisory capacity over other lawyers to take measures to establish that the other lawyers' conduct follows the Rules.[274] The Comment recognizes that the means of compliance with Rule 5.1(a) and Rule 5.1(b) must be tailored to the size and circumstances of the firm, except that continuing legal education may be appropriate for the members of large or small firms.[275] Rule 5.1(c) imposes liability on one lawyer for another's violations if the lawyer ordered or ratified the conduct, or if the lawyer is a partner or supervisory attorney and knows of the violation while an opportunity exists for corrective action but the lawyer fails to take such action.[276] The Comment notes that Rule 5 and Rule 8.4(a) are the sole rules imposing disciplinary liability upon lawyers for violations by another lawyer.[277] The Code's disciplinary rules did not explicitly address the requirements of Rule 5.1. However, Disciplinary Rule 1-103(A) demanded that a lawyer report to the proper authorities any unprivileged knowledge of another lawyer's professional misconduct.[278] Disciplinary Rule 1-103(A) is analogous only because it could impose disciplinary liability upon one lawyer for another's violations of professional conduct rules.

Rule 5.2 notes that all lawyers are responsible for conforming their conduct to the Rules even though their action is directed by a supervisory lawyer.[279] When the appropriate course of conduct is not readily apparent, a subordinate lawyer who acts at the direction of a supervisory lawyer

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[271]Code, *supra* note 20, DR 7-102(A)(1), -106(C)(2), -108(D), -108(E).

[272]Rules, *supra* note 11, Rule 5.1. The Comment to Rule 5.1 expands the scope of a firm to legal departments of government agencies and organizations. Rules, *supra* note 11, Rule 5.1 comment.

[273]Rules, *supra* note 11, Rule 5.1(a).

[274]Rules, *supra* note 11, Rule 5.1(b).

[275]Rules, *supra* note 11, Rule 5.1 comment.

[276]Rules, *supra* note 11, Rule 5.1(c).

[277]Rules, *supra* note 11, Rule 5.1(c) comments.

[278]Code, *supra* note 20, DR 1-103(A).

[279]Rules, *supra* note 11, Rule 5.2.

does not violate the Rules, if the action is reasonable.[280] The Code had no correlative disciplinary rule.

Rule 5.3 echoes the partner's or supervisory lawyer's obligations imposed in Rule 5.1, except the duty is one of controlling nonlawyer employees.[281] The Comment charges a lawyer with the duty to supervise and to instruct nonlawyers on confidentiality and other relevant ethical considerations.[282] The lawyer should assume responsibility for the non-lawyer's work product. Additionally, the lawyer must consider that the nonlawyer employees have not completed legal training and are not subject to discipline under the Rules.[283] As with Rule 5.1, Rule 5.3 has no counterpart in the Code. Disciplinary Rule 4-101(D) cautioned lawyers to take reasonable measures to ensure that employees and third parties did not reveal a client's confidences and secrets.[284] Disciplinary Rule 7-107(I) was aimed at prevention of extrajudicial statements by employees and others, if the lawyer was prohibited from making the extrajudicial statements.[285]

Rule 5.4, requiring lawyers to avoid control of their professional independence by a nonlawyer, draws upon the teachings of several disciplinary rules found in the Code. Rule 5.4 states:

> (a) A lawyer or law firm shall not share legal fees with a nonlawyer, except that:
>
> (1) an agreement by a lawyer with the lawyer's firm, partner, or associate may provide for the payment of money, over a reasonable period of time after the lawyer's death, to the lawyer's estate or to one or more specified persons;
>
> (2) a lawyer who undertakes to complete unfinished legal business of a deceased lawyer may pay to the estate of the deceased lawyer that proportion of the total compensation which fairly represents the services rendered by the deceased lawyer; and
>
> (3) a lawyer or law firm may include nonlawyer employees in a compensation or retirement plan, even though the plan is based in whole or in part on a profit-sharing arrangement.
>
> (b) A lawyer shall not form a partnership with a nonlawyer

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[280] *Id.*

[281] RULES, *supra* note 11, Rule 5.3.

[282] RULES, *supra* note 11, Rule 5.3 comment.

[283] *Id.*

[284] CODE, *supra* note 20, DR 4-101(D).

[285] CODE, *supra* note 20, DR 7-107(I).

> if any of the activities of the partnership consist of the practice of law.
>
> (c) A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services.
>
> (d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit if:
>
> > (1) a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;
> >
> > (2) a nonlawyer is a corporate director or officer thereof; or
> >
> > (3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.[286]

The applicable provisions of the Code are Disciplinary Rules 3-102(A), 3-103(A), 5-107(B) and 5-107(C), and Ethical Consideration 5-24.[287]

Canon 3 in the Code stated "A Lawyer Should Assist in Preventing the Unauthorized Practice of Law."[288] Rule 5.5 states a lawyer must not cooperate with a nonlawyer in conduct that furthers the unauthorized practice of law by the nonlawyer.[289] The Comment excepts from the prohibitions of the Rule a lawyer employing a nonlawyer to perform work for which the lawyer remains responsible.[290] Also, a lawyer may instruct a nonlawyer on legal issues pertinent to the nonlawyer's employment, or in cases where the nonlawyer is proceeding pro se in a matter.[291] In the Code, Disciplinary Rule 3-101 expressed the same concerns as Rule 5.5.[292]

Rule 5.6 condemns employment agreements or any other contracts which purport to restrict a lawyer's ability to practice law, except as such an agreement concerns retirement benefits.[293] According to the Comment, the Rule encompasses a settlement on behalf of a client in which the lawyer agrees to limit representation of other persons.[294] Rule

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[286] RULES, *supra* note 11, Rule 5.4.

[287] CODE, *supra* note 20, DR 3-102(A), -103(A), 5-107(B), -107(C), EC 5-24.

[288] CODE, *supra* note 20, Canon 3.

[289] RULES, *supra* note 11, Rule 5.5.

[290] RULES, *supra* note 11, Rule 5.5 comment.

[291] *Id.*

[292] CODE, *supra* note 20, DR 3-101(A), (B).

[293] RULES, *supra* note 11, Rule 5.6.

[294] RULES, *supra* note 11, Rule 5.6 comment.

5.6 compares favorably with Disciplinary Rules 2-107(A) and 2-107(B).[295]

F. Pro Bono Services

The duty of the legal profession to engage in pro bono publico service, the subject of Rule 6, is couched in permissive terms urging compliance.[296] Yet the Comment to Rule 6.1 states that the Rule "is not intended to be enforced through disciplinary process."[297] Rule 6.1 lists several means by which an attorney can fulfill the moral obligation to perform pro bono services. Rather than the traditional method of performing work for no fee or a reduced fee, a lawyer may contribute financial support to "organizations that provide legal services to persons of limited means."[298] As in the present Rules, the Code did not attach disciplinary repercussions for failure to engage in pro bono work. The Code did, however, include three ethical considerations advancing the laudatory nature of pro bono service.[299]

Rule 6.2 advises lawyers not to refuse an appointment to represent a person made by a tribunal unless good cause exists.[300] Good cause may include the following: the representation could result in a violation of the Rules, the representation will probably result in a burdensome financial loss, or the representation is so repugnant to the lawyer that it is likely to color the attorney-client relationship or the lawyer's ability to competently represent the client.[301] Again, no disciplinary rule compares to Rule 6.2, but Ethical Considerations 2-29 and 2-30 together communicated the same concerns.[302] While Ethical Consideration 2-29 stated that the refusal of an appointment should not be based upon a repugnance for the person or cause,[303] Ethical Consideration 2-30 allowed refusal of employment if the lawyer's personal feelings in the matter could affect the representation of the client.[304]

Rule 6.3 allows a lawyer to participate in a legal services organization as a member, director or officer even though clients in the lawyer's private practice may have interests differing from those of the persons served by the organization.[305] The lawyer must not knowingly become

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[295] *Compare* RULES, *supra* note 11, Rule 5.6 *with* CODE, *supra* note 20, DR 2-107(A), (B).

[296] RULES, *supra* note 11, Rule 6.1.

[297] RULES, *supra* note 11, Rule 6.1 comment.

[298] RULES, *supra* note 11, Rule 6.1.

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[300] RULES, *supra* note 11, Rule 6.2.

[301] *Id.*

[302] CODE, *supra* note 20, EC 2-29.

[303] *Id.*

[304] CODE, *supra* note 20, EC 2-30.

[305] RULES, *supra* note 11, Rule 6.3.

personally involved in action taken by the organization which would negatively affect the lawyer's responsibilities to a private client.[306] Conversely, the lawyer must not make a decision which would adversely affect a client of the organization in order to benefit a private client.[307] The Code does not contain provisions similar to Rule 6.3.

Rule 6.4 provides that a lawyer may participate as a member, director or officer of an entity dedicated to reform of the law even though the reform may involve interests of a client.[308] If a client's interests may be materially advanced by a decision in which the lawyer participates, the lawyer must reveal that information, but not necessarily the client's identity.[309] This Rule is an extension of Rule 6.3 and has no counterpart in the Code.

Rule 7, as adopted in Indiana, is materially different than the provisions of the Model Rules. The version of Rule 7.1 as adopted in Indiana is substantially the same as Disciplinary Rule 2-101 on publicity and advertising.[310] However, Disciplinary Rule 2-101 prohibited a public communication which included a pictorial depiction of a person who was not a lawyer in the firm unless a specific disclaimer appeared on the communication. That prohibition was removed from Rule 7.1.[311] Rule 7.1 in the Model Rules treated the subject of false or misleading statements or communications, or implications that certain results may be obtained by the lawyer.[312]

Rule 7.2 regarding professional notices, letterhead, office names and law lists is identical to Disciplinary Rule 2-102 in the Code.[313] Model Rule 7.2 involves advertising and communication aimed at obtaining clients.[314] The Comment suggests that Rule 7.2 dispels the traditionally held view that lawyer advertisements should not be for the purpose of seeking clients.[315]

The version of Rule 7.3 adopted in Indiana is the same as Disciplinary Rule 2-103 on recommending or soliciting professional employment.[316] Rule 7.3 specifically does not allow many types of written communication with prospective clients, and specifically prohibits any "in-person contact" soliciting employment when the potential client has not sought the

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[306]*Id. See also* RULES, *supra* note 11, Rule 1.7.

[307]RULES, *supra* note 11, Rule 6.3.

[308]RULES, *supra* note 11, Rule 6.4.

[309]*Id.*

[310]*Compare* RULES, *supra* note 11, Rule 7.1 *with* CODE, *supra* note 20, DR 2-101.

[311]*Id.*

[312]MODEL RULES, *supra* note 4, Rule 7.1.

[313]RULES, *supra* note 11, Rule 7.2; CODE, *supra* note 20, DR 2-102.

[314]MODEL RULES, *supra* note 4, Rule 7.2.

[315]*Id.*

[316]*Compare* RULES, *supra* note 11, Rule 7.1 *with* CODE, *supra* note 20, DR 2-101.

lawyer's services.[317] The Model Rule 7.3 addresses the subject of contact with potential clients but generally distinguishes between communication to solicit employment which targets a recipient and those solicitations in the form of a letter or advertising circular delivered to persons whose needs for legal services are unknown.[318]

Rule 7.4, the last section within Rule 7, is worded identically to Disciplinary Rule 2-104, except references to Code sections are altered.[319] Rule 7.4 discusses the limitation of a lawyer's practice to certain areas of law. In general, direct or indirect statements that a lawyer is a specialist in a certain area of law are prohibited except by lawyers who engage in patent, trademark or admiralty law.[320] The Rule does not, however, preclude statements that a lawyer's practice is limited to a particular area of law.[321] Although Model Rule 7.4 is similar to Indiana's version of Rule 7.4, the Comment to the Model Rule recommends against a statement that the lawyer's practice "is limited to" or "concentrated in" a certain area because those phrases generally connote specialization in the fields.[322]

H. *Professional Integrity*

Rule 8 comes under the heading "Maintaining the Integrity of the Profession" and its five sections cover "Bar Admission and Disciplinary Matters," "Judicial and Legal Officials," "Reporting Professional Misconduct," "Misconduct" and "Jurisdiction."[323] Rule 8.1 prohibits either an applicant for admission to the bar or a lawyer connected with such an application or a disciplinary matter from making false statements of fact, or failing to disclose necessary facts in connection with those proceedings.[324] Although Rule 8.1 covers familiar ground in its prohibitions of certain actions by lawyers, this Rule is unique in that it extends to persons who have not yet been admitted to the Bar and subjects those persons to disciplinary action after admission.[325] Rule 8.1 is parallel to Disciplinary Rule 1-101(A) with respect to an application for admission to the Bar.[326]

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[317] RULES, *supra* note 11, Rule 7.3.

[318] MODEL RULES, *supra* note 11, Rule 7.3.

[319] *Compare* RULES, *supra* note 11, Rule 7.4 *with* CODE, *supra* note 20, DR 2-104.

[320] RULES, *supra* note 11, Rule 7.4.

[321] *Id.*

[322] MODEL RULES, *supra* note 4, Rule 7.4 comment.

[323] RULES, *supra* note 11, Rule 8.

[324] RULES, *supra* note 11, Rule 8.1. A disclaimer at the end of Rule 8.1 states that "this rule does not require disclosure of information otherwise protected by Rule 1.6." *Id.*

[325] *Id.*

[326] CODE, *supra* note 20, DR 1-101(A).

Rule 8.2 prohibits a lawyer from making a statement about a judge, legal official or a candidate for those offices that is either false or made "with reckless disregard as to its truth or falsity."[327] Further, a lawyer who is a candidate for judicial office must comply with applicable provisions of the Code of Judicial Conduct.[328] Portions of Rule 8.2 are identical in effect to the provisions of Disciplinary Rule 8-102;[329] but with respect to lawyers who are candidates for judicial office there exists no counterpart in the Code.

Rule 8.3 requires a lawyer to inform the proper authorities of professional misconduct of either another lawyer or a judge that "raises a substantial question" as to the fitness of the lawyer or judge.[330] Rule 8.3 is parallel to Disciplinary Rule 1-103 except that the Rule gives the lawyer with knowledge of a violation some flexibility in deciding whether to report an incident of professional misconduct. The Comments explain that rules requiring the reporting of every offense were "unenforceable" and, therefore, only offenses which "a self-regulating profession must vigorously endeavor to prevent" should be reported.[331]

Rule 8.4 defines professional misconduct for a lawyer as any act in violation of the Rules, certain criminal acts, fraudulent or dishonest acts and interference with the administration of justice.[332] The Comments accompanying Rule 8.4 explain that not all criminal acts are included in the purview of "professional misconduct" because a lawyer should be professionally, as opposed to criminally, answerable only for "offenses that indicate lack of those characteristics relevant to law practice."[333] Those offenses include crimes involving violence, dishonesty and breach of trust.[334] The sections of Rule 8.4 do not deviate significantly from the provisions of Disciplinary Rule 1-102(A)[335] and Rule 8.4's proscription of implying an ability to influence a government agency or official is identical to Disciplinary Rule 9-101(c).[336] Rule 8.5 closes the Rules of Professional Conduct by asserting disciplinary jurisdiction over any lawyer admitted to practice in this jurisdiction, regardless of whether the lawyer is also engaged in practice elsewhere.[337]

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[327] RULES, *supra* note 11, Rule 8.2.
[328] *Id.*
[329] CODE, *supra* note 20, DR 8-102.
[330] RULES, *supra* note 11, Rule 8.3.
[331] CODE, *supra* note 20, DR 1-103.
[332] RULES, *supra* note 11, Rule 8.4.
[333] RULES, *supra* note 11, Rule 8.4 comment.
[334] *Id.*
[335] CODE, *supra* note 20, DR 1-102(a).
[336] CODE, *supra* note 20, DR 9-101(c).
[337] RULES, *supra* note 11, Rule 8.5.

III. Conclusion

Generally, the new Rules require full disclosure to a client of matters relevant to the representation. When a potential conflict of interest can be foreseen by the attorney, rejection of employment or withdrawal from representation may be appropriate. If the potential for conflict is minimal, disclosure and/or the client's consent to the representation may be required. If the new Rules were reduced to two watch words, these words would be "disclosure" and "consent." While the new Rules form a solid framework for attorney-client relationships and attorney ethical considerations, common sense must prevail. An elevated standard of care may be required given certain circumstances or contingencies, not all of which can be addressed within the Rules.

Property Survey 1987

WALTER W. KRIEGER*

I. SHOPPING CENTER LEASES

During this survey period there were three reported landlord-tenant cases involving shopping center leases. The cases point out some of the common and not so common problems that can arise in such leases.

Shopping center leases present special problems. While the center's space is leased to individual tenants, the center itself is a carefully planned enterprise that functions as a single unit.[1] Tenants are not randomly selected but instead are carefully chosen according to a plan. The shopping center is designed in such a way that it will attract a particular type of customer or will best meet the shopping needs of the surrounding community.[2] Since it is common practice in shopping center leases to include rental based on a percentage of gross sales in addition to a minimum base rent, it is in the interest of the landlord to insure that there is a high patronage of the center.[3] This can best be insured by a proper tenant mix.[4] It is generally not in the best interest of the landlord to have similar businesses operating in the shopping center since they would be competing for the same customers and would not lead to an overall increase in the number of potential customers, whereas a variety of diverse businesses would attract different customers to the

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[1]Fogel, *Executory Contracts and Unexpired Leases in the Bankruptcy Code*, 64 MINN. L. REV. 341, 359 (1980).

[2]Roswick and McEvily, *Use Clauses in Shopping Center Leases: The Effect of the Tenant's Bankruptcy*, 14 REAL EST. L.J. 3, 4-5 (1985) [hereinafter Roswick & McEvilly].

[3]Note, *The Antitrust Implications of Restrictive Covenants in Shopping Center Leases*, 86 HARV. L. REV. 1201, 1206 n.19 (1973); Schear & Sheehan III, *Restrictive Lease Clauses and the Exclusion of Discounters From Regional Shopping Centers*, 25 EMORY L.J. 609, 612 (1976). "[T]enant mix . . . may be as important . . . as the actual promised rental payments, because certain mixes will attract higher patronage of the stores in the center, and thus a higher rental for the landlord from those stores that are subject to a percentage of gross receipts rental agreement. 11 U.S.C.S. § 365 at 222 (Law. Co-op. 1985) (quoting H.R. REP. No. 595, 95th Cong., 2d Sess. 348-349, *reprinted in* 1977 U.S. CODE CONG. & ADMIN. NEWS 5963, 6305).

[4]Tenant mix can be defined as developing a variety of uses and juxtaposing tenants in such a way as to permit the public to "shop the center, not shop one store and run home." *In re* TSW Stores of Nanuet, Inc., 34 Bankr. 299, 302 (Bankr. S.D.N.Y. 1983).

center, thereby creating more potential sales to all center tenants.[5] For this reason it is common for the landlord to include a use clause (sometimes referred to as a purpose clause) in the lease prohibiting tenants from engaging in already existing center businesses.[6]

The success of the shopping center will depend upon the landlord's ability to attract the best anchor tenants.[7] Because anchor tenants are vital to the success of the shopping center, they are able to negotiate better terms. They may insist upon a noncompetition clause in the lease or perhaps even a veto power over the selection of other tenants.[8] The lesser tenants are not in as favorable of a position and are likely to pay a higher rent and have more restrictive terms forced upon them for the privilege of becoming a tenant in the shopping center.[9]

A. *Use Clauses, Breach of Lease*

In *Ray-Ron Corp. v. DMY Realty Co.*,[10] Ray-Ron Corp. (Ray-Ron) d/b/a Noble Roman's Pizza, leased a free-standing building in a shopping

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[5]Roswick & McEvily, *supra* note 2, at 22-23 (citing *In re TSW*, 34 Bankr. at 303). In addition, such competition might decrease the interest of potential tenants to lease space in the "shopping center because there would be fewer categories of business to attract customers." Roswick & McEvily, *supra* note 2, at 23. In some situations, however, competition will be beneficial. Competition between women's apparel and shoe stores in the same shopping center will lead to comparison shopping which is beneficial to both the competing stores and the other tenants since it will attract more patrons to the center. *Id.* at 22-23.

[6]For a discussion of various justifications for such clauses, see Note, *supra* note 3, at 1218-38.

[7]Pollack, *Clauses in a Shopping Center Lease*, 16 Prac. Law. 31, 32 (May 1970). Anchor tenants are physically located at "anchor points" in the shopping center in such a way as to cause the customers to pass by the line of lesser tenants while walking from one anchor to another. Thus these line tenants will profit from the impulse buying of the customers. Note *supra* note 3, at 1205 n.16.

Roswick & McEvily, *supra* note 2, indicate that there are four different types of shopping centers. A "neighborhood" center provides convenience goods and personal services and the principal (anchor) tenant is usually a supermarket. A "community" center provides "soft ware" (men's, women's and children's apparel) and hard ware as well as convenience goods and personal services. The tenant who usually anchors this type of center is a department store or variety store. The "regional" center is an enclosed mall which provides general merchandise, apparel, furniture and home furnishings. This type center is usually anchored by one or two full line department stores. The "super-regional" center is one which is anchored by at least three major department stores. *Id. See also* Eagle, *Shopping Center Control: The Developer Beseiged*, 51 J. Urban L. 585, n.1 (1973-74).

[8]One justification used by major tenants is their concern for the "image" of the shopping center. Schear & Sheehan, *supra* note 3, at 612.

[9]Pollack, *supra* note 7, at 32.

[10]500 N.E.2d 1163 (Ind. 1986).

center from DMY Realty Company (DMY). Problems developed when another tenant in the shopping center, Village Pantry, moved out and DMY proposed to lease the space to either a Chinese restaurant or a restaurant called "John's Hot Stew." Ray-Ron objected to the proposed use, citing a clause in its lease wherein DMY promised not to permit the sale of competitive food or beverage products within the shopping center.[11] Unable to obtain Ray-Ron's consent to these proposals, DMY brought this action claiming that Ray-Ron had breached the clause in the lease limiting the use of the premises "for a restaurant and/or retail sale of liquor and associated commissary and for no other purpose or purposes, without the written consent of the Lessor," by placing arcade-type machines in the restaurant.[12] Later, an additional count was added alleging that Ray-Ron had breached the lease by failing to include the gross income from the machines in the percentage rent.[13] DMY filed a motion for partial summary judgment asking the trial court to affirm its right to evict the tenant.[14] The trial court granted DMY's motion for partial summary judgment, and DMY then filed for a writ of assistance in evicting Ray-Ron; whereupon Ray-Ron filed an appeal.[15] The court of appeals determined that the appeal was not timely and dismissed.[16] The Indiana Supreme Court disagreed and heard the appeal.[17]

The supreme court first examined the nature of the use clause in the lease, noting that had the clause merely specified the purpose of the lease without prohibiting other uses it would have been permissive only. [18] However, in this case the purpose clause contained a prohibition on other uses of the leased premises, making it restrictive and entitling the lessor to limit the use of the premises to those specified in the lease.[19] The court found, however, that even where the lessee puts the premises to a use outside the term of the lease such action may not

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[11]*Id.* at 1164.

[12]*Id.* DMY also requested the court to declare the non-competition clause in the lease to be void or alternatively to declare that DMY's proposed use would not violate the clause. *Id.* These issues were not addressed by the court.

[13]*Id.* It is not uncommon for a commercial lease to include a percentage of gross income as rent in addition to the base rent.

[14] In the motion, DMY stated that Ray-Ron had breached the lease by placing the game machines in the restaurant and by not including the gross income from video machines, record player, pay telephone, balloon machine and a cigarette machine in determining the percentage rent; that DMY had given notice of these breaches and had elected to terminate the lease. 500 N.E.2d at 1164-65.

[15]*Id.* at 1165.

[16] Ray-Ron Corp. v. DMY Realty Company, 485 N.E.2d 937 (Ind. Ct. App. 1985).

[17]*Ray-Ron*, 500 N.E.2d at 1165.

[18]*Id.* (citing Silkey v. Malone, 123 Ind. App. 395, 111 N.E.2d 665 (1953)).

[19]*Id.* (citing Schaub v. Wright, 79 Ind. App. 56, 130 N.E. 143 (1921)).

result in a breach if the use is casual or intermittent or where the use is deemed incidental to the main purpose of the lease.[20]

The court concluded that the term "restaurant" does not limit the use to serving food and drink, pointing out that Noble Roman's restaurants customarily show movies as entertainment, but that no one would seriously claim that Noble Roman's is a movie house rather than a restaurant.[21] With 94% of the restaurant's total income attributable to the sale of food and drinks, it did not become a "video arcade" because of the existence of seven machines which allow the patrons to play Pac-Man and Galaga. The court noted that whether Ray-Ron had violated the lease by not reporting income from sources other than food and drink was a separate issue.[22] The court vacated the summary judgment and remanded the case for further proceedings on the merits.[23]

B. *Subleases, Options to Extend Lease and Percentage Rent*

In *F.W. Woolworth Co. v. Plaza North, Inc.*,[24] F.W. Woolworth Co. (Woolworth) leased premises in a shopping center for a Woolco Department Store from Plaza North, Inc. (Plaza North). The lease provided that Woolworth was to pay a minimum rent of $113,297.00 in equal monthly installments and rent based on a percentage of Woolco's annual gross sales. The lease further provided that Woolworth could at any time elect to discontinue the operation of its Woolco store by sending Plaza North written notice of its intent to do so, and that Plaza North could, within 90 days after the date of mailing of the notice, elect to cancel and terminate the lease.[25] In addition, the fifteen (15) year lease contained five successive options to extend the term of the lease up to five years on each option.[26]

In 1982, during the first option period, Woolworth decided to close all of its Woolco stores nation wide. On October 4, 1982, Woolworth sent written notice to Plaza North of its intent to discontinue operation of the Woolco store. Plaza North did not exercise its option to terminate the lease within the 90 day period, but instead chose to treat the lease

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[20]*Id.* at 1166 (citing Galloway v. Ortega, 61 Misc. 2d 539, 541, 305 N.Y.S.2d 546, 549 (1969)).

[21]*Ray-Ron*, 500 N.E.2d 1163, 1166.

[22]*Id.*

[23]*Id.*

[24]493 N.E.2d 1304 (Ind. Ct. App. 1986).

[25]*Id.* at 1307. Articles 5 and 5A of the lease contained the provisions concerning the right to terminate operations, the right of the landlord to terminate the lease and the change in the rent resulting from tenant's notice of discontinuance and the landlord's failure to exercise his option to cancel the lease. *Id.*

[26]*Id.*

as continuing.[27] On April 15, 1983, Woolworth and SCOA Industries, Inc. (SCOA) entered into an agreement to sublease the premises until January 30, 1997 with two options to extend the sublease for five years each. Woolworth then sent a letter to Plaza North that it was exercising its second and third options to extend the term of the original lease.[28]

Plaza North, after attempting to discover the terms of the agreement between Woolworth and SCOA, filed a complaint for injunction and declaratory judgment claiming that the sublease was really an assignment and that Woolworth had violated the terms of the overlease.[29] Plaza North asked the court for a judicial declaration of the rights of the parties to the lease and sublease. The trial court granted summary judgment in favor of Plaza North, finding: (1) that Woolworth did not have the right to extend the term of the lease after it ceased operations and thus the lease would end on January 31, 1987; (2) that Woolworth's agreement with SCOA was a valid sublease but would expire when the overlease terminated on January 31, 1987; and (3) that Plaza North had the right to receive rent based on a percentage of the amount of gross sales on the premises made by SCOA or any other subtenant (substituting the sales by SCOA for those of Woolco in Article 5 of the original lease), thus requiring Woolco to pay rent based on the gross sales of SCOA.[30] Appeal and cross appeal were taken.

On appeal, the court reviewed the three findings of the trial court. On the question of Woolworth's right to extend the lease after ceasing operations of the Woolco store, the court noted that there was nothing in the lease suggesting that the unexercised options were no longer valid after discontinuation of Woolco operations. Article 3 of the lease stated that the term of the lease ended on January 31, 1982, unless extended or earlier terminated. Likewise, Article 29 of the lease provided that all lease terms apply to the extended terms. Neither article made reference to Woolworth ceasing operations.[31] It should also be noted that Article 5A, which governed the cessation of operations by Woolworth, clearly contemplated that the lease might continue after cessation of operations. Nothing in Article 5A indicated the unexercised options to extend were no longer valid.[32]

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[27]More than three weeks after the 90 day period had expired Plaza North notified Woolworth that it still desired to terminate the lease but Woolworth replied that Plaza North had missed its deadline and that Woolworth did not want the lease terminated. *Id.* at 1306.

[28]*Id.*

[29]*Id.*

[30]*Id.*

[31]*Id.* at 1307.

[32]*Id.*

The appellate court thus concluded that the trial court had erred and that Woolworth could exercise the options to extend after it had ceased operation of the store.[33] Since Woolworth had already exercised one 5-year option which extended the present term until January 31, 1987, at the time it notified Plaza North of its intent to exercise two more extensions, it had complied with the requirement of Article 29 that notice be sent to Plaza North no later than one year prior to the expiration of the term.[34]

The trial court had concluded that the Woolworth/SCOA agreement was a sublease and not an assignment. The issue of whether the agreement was a sublease or an assignment was critical. Article 15 prohibited an assignment without the consent of the landlord, but did not prohibit Woolworth from subleasing the premises.[35] Plaza North argued that it was an assignment because the term was for a period beyond that of the overlease. A sublease must be for a term less than the lease. If the transfer is for the full term of the lease without any reversion in the original tenant, then it is an assignment and not a sublease.[36] Here the sublease was to expire January 30, 1997, unless extended or sooner terminated. Plaza North argued that this is beyond the present term of the overlease, which at the time of the agreement was to end on January 31, 1986. The court of appeals rejected this argument, pointing out that the agreement between Plaza North and Woolworth gave Woolworth a fixed term of 17 years and an optional term of 25 years. The previous exercise of one option gave Woolworth an absolute term until 1987 and the four unexercised options give Woolworth a contingent term until 2007 at its option.[37] Thus Woolworth did not convey its entire interest to SCOA. Instead, it conveyed the remainder of its absolute (vested) term and a portion of its contingent term.[38]

The final issue addressed by the court was whether the percentage rent clause in the lease gave Plaza North a right to a percentage rent based on SCOA's sales. The court found that the lease did not give Plaza North a percentage rent following the discontinuation of Woolco operations and that the trial court was in error. The language of Article 5A is clear and unambiguous:

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[33]*Id.* at 1307-08.

[34]*Id.* at 1308.

[35]Article 15 provided, "Except as hereinafter provided, the Tenant agrees not to assign . . . this lease without first obtaining the written consent of the Landlord. . . . The Tenant is hereby given the right . . . to sublet the demised premises or any part thereof. . . ." *Id.* n.1.

[36]For a discussion of the distinction between subleases and assignments, see Krieger, *Developments in Property Law*, 20 IND. L. REV. 305, 315-321 (1987).

[37]*Woolworth*, 493 N.E.2d at 1309.

[38]*Id.*

> Should the Landlord fail to exercise its said option [to cancel] and should the Tenant at any time thereafter discontinue the operation of its said store then and in any such event . . . the rent which Tenant shall pay to the Landlord during the remainder of the term of this lease shall be the rent more particularly set forth in said Article 5, and the word "minimum" in said Article 5 shall be deemed deleted. Upon the discontinuance of the operation of said store, all of the covenants and provisions contained in the preceding paragraphs of this article shall be of no further force and effect.[39]

Under the clear and unambiguous language of Article 5A, if the tenant ceases operations and the landlord chooses not to cancel the lease, the payment of percentage rent is deleted from the lease.[40]

Finally, Plaza North argued that where the lease provides for the payment of a percentage rent the lessee impliedly agrees to act in good faith so as not to deprive the lessor of his percentage rent. The court agreed but noted that there was no evidence that Woolworth acted in bad faith. The decision to close the Woolco stores was made in good faith and was based on a nation-wide decision unrelated to the lease under consideration.[41]

In conclusion the court found that Woolworth had a right to sublet the premises under the lease, that it had a right to exercise two of its four remaining options to extend the terms of the lease after it had ceased Woolco operations and that Woolworth was not liable for any percentage rent based on SCOA's sales.[42] This case is an excellent example of why the drafting of commercial shopping center leases is such a difficult task. One must anticipate the unexpected. In this case it appears that Woolworth reaped a windfall because Plaza North had not anticipated that when it chose not to cancel the lease, Woolworth would relet the premises and exercise its option to extend the lease.

C. *Use Clauses, Assignments and Duty of Landlord to Mitigate Damages*

At common law the landlord was under no duty to mitigate damages when the tenant abandoned the leased premises before the end of the term,[43] unless there was a mandatory reletting clause in the lease.[44] Where

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[39] *Id.* at 1310.

[40] *Id.*

[41] *Id.* at 1311.

[42] *Id.*

[43] R. Cunningham, W. Stoebuck & D. Whitman, The Law of Property § 6.80, at 404 (1984).

[44] *See, e.g.*, Carpenter v. Wisniewski, 139 Ind. App. 325, 215 N.E.2d 882 (1966); Waffle v. Ireland, 86 Ind. App. 119, 155 N.E. 513 (1927).

the reletting clause was permissive only, the landlord was not required to relet the premises to mitigate damages.[45] While this may still be the majority rule there is a rapidly growing minority view that when the tenant abandons the premises the landlord, under general contract law, must attempt to mitigate his damages.[46]

Hirsch v. Merchants National Bank and Trust Co.[47] was the first Indiana decision to adopt the minority view. In *Hirsch*, the court held that even where the lease contains only a permissive reletting clause allowing the landlord the option to relet should the tenant vacate the premises, the landlord "is still required to use such diligence as would be exercised by a reasonably prudent man under similar circumstances to relet the premises if possible."[48] *Hirsch* and later cases, however,

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[45]Even before the courts determined that there was a duty to mitigate damages the landlords inserted a reletting clause in the lease so that if the landlord chose to voluntarily mitigate his damages he would not be charged with a surrender and acceptance of the leased premises. A surrender by operation of law will arise when the parties to the lease do some act so inconsistent with the landlord-tenant relationship that the court will imply that the parties must have agreed to consider the lease terminated. Paxton Realty Corp. v. Peaker, 212 Ind. 480, 9 N.E.2d 96 (1937); N. Indiana Steel Supply Co. v. Chrisman, 139 Ind. App. 27, 204 N.E.2d 668 (1966). Without the reletting clause the landlord's reentry could be viewed as a surrender and acceptance, thereby ending the tenant's obligations under the lease, including the obligation to pay rent. Grueninger Travel Serv. v. Lake County Trust Co., 413 N.E.2d 1034, 1041-42 (Ind. Ct. App. 1980). If the court adopts the minority view that there is a duty on the part of the landlord to mitigate damages, then it would be illogical to conclude that the landlord's reentry to relet the premises was a surrender and acceptance. State v. Boyle, 168 Ind. App. 643, 646, 344 N.E.2d 302, 304 (1976).

[46]For a list of cases on landlord's duty to mitigate damages, see Annotation *Landlord's Duty, on Tenant's Failure to Occupy, or Abandonment of, Premises, to Mitigate Damages by Accepting or Procuring another Tenant*, 21 A.L.R.3d 534 (1968).

[47]166 Ind. App. 497, 336 N.E.2d 833 (1975).

[48]*Id.* at 502, 336 N.E.2d at 836. In *Hirsch* there was a permissive reletting clause allowing the landlord to relet the premises following the tenant's abandonment. Since nearly all written leases contain a permissive reletting clause allowing the landlord to reenter and relet the premises in the event of the tenant's default of the lease, it is not surprising that in all but a few of the Indiana cases which followed the *Hirsch* decision, it was clear from the facts that the lease in question contained a permissive reletting clause. Some of the decisions seemed to emphasize the fact that there was a reletting clause which authorized the landlord to reenter and relet the premises. These decisions seem to tie the duty to mitigate damages to the permissive reletting clause. *E.g.*, Sandor Development Co. v. Reitmeyer, 498 N.E.2d 1020, 1022-23 (Ind. Ct. App. 1986); *Grueninger* 413 N.E.2d 1043.

In other cases, the courts seem to state the rule in broader language suggesting that the landlord has a general contractual duty to mitigate his damages and that the reentry by the landlord will not operate as a surrender and acceptance of the lease. *E.g.*, Sigsbee v. Swathwood, 419 N.E.2d 789 (Ind. Ct. App. 1981); State v. Boyle, 168 Ind. App. 643, 344 N.E.2d 302 (1976) (finding a duty on the landlord to attempt to relet to mitigate

have held that where there is no mandatory reletting clause the burden of proof is on the tenant to show the landlord failed to use due diligence.[49]

The questions of the landlord's duty to attempt to relet the premises to mitigate his damages when the tenant vacates the premises before the end of the term and the effect of a use clause on this duty were raised in *Sandor Development Co. v. Reitmeyer.*[50] In *Sandor*, John and Fern Reitmeyer (Reitmeyers) leased space in a shopping center from Sandor Development Co. (Sandor). Later, the Reitmeyers sublet adjoining space leased to Kadel's Holiday Shoppe, Inc. (Kadel's). The Reitmeyers operated a music store on the premises, in accord with a purpose clause in their lease.[51] Both leases (Reitmeyers' lease and Kadel's lease) terminated on the last day of February 1973. On August 25, 1972, the Reitmeyers exercised their option to renew the leases for another 5 year term. On October 1, 1973, Sandor accepted an assignment of the leases by the Reitmeyers to the Conservatory of Music Inc. (Conservatory), subject to the continuing liability of the Reitmeyers and Kadel's.

In May 1976 the Reitmeyers sent a letter informing Sandor that they were moving the Conservatory from the shopping center sometime in July.[52] On May 20, 1976, the Reitmeyers tendered a written proposal to Sandor stating that Bernard Strange, who operated a retail carpet store, was willing to become an assignee of the leases. Sandor rejected the proposal. The Conservatory paid the rent for June, and moved out the next month. Sandor continued to make efforts to relet the premises both before and after the Conservatory moved out. After contacting a number of businesses, Sandor was able to lease a portion of the premises

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damages without any indication of whether there was a reletting clause in the lease authorizing the landlord to relet the premises). It would appear that the concern of those courts appearing to limit the duty to relet to situations where a reletting clause is contained in the lease is a fear that the entry by the landlord without such an authorization would be viewed as a surrender and acceptance, ending the duty of the tenant to pay rent. *Grueninger* 412 N.E.2d at 1037-45; *Sandor* 498 N.E.2d at 1022-23. However, the language in the decisions imposing a general duty on the landlord to make reasonable efforts to relet the premises to mitigate damages emphasizes that a mere attempt by the landlord to relet the premises to mitigate damages will not result in a surrender and acceptance by operation of law. *Sigsbee*, 419 N.E.2d at 799; *Boyle*, 168 Ind. App. at 646-47, 344 N.E.2d at 304-05. The language in the *Hirsh* decision seems to support the *Boyle-Sigsbee* rationale. *Hirsch*, 166 Ind. App. at 501-505, 336 N.E.2d at 836-37.

[49]*E.g.*, *Sigsbee*, 419 N.E.2d at 797; *Grueninger*, 413 N.E.2d at 1039-40; *Hirsch*, 166 Ind. App. at 502, 366 N.E.2d at 836.

[50]498 N.E.2d 1020 (Ind. Ct. App. 1986).

[51]The lease described their business as the "'sale of musical instruments, financing musical instruments, accessories, parts, lessons and associated products.'" *Id.* at 1021.

[52]The Reitmeyers stated that there were many reasons for the move but specifically mentioned failure to repair defects in the premises. *Id.*

to Majestic Paints on April 15, 1977, and another portion to the Pop Shoppe on October 1, 1977.[53]

In a subsequent suit for damages filed by Sandor, the defendants (Reitmeyers, Kadel's and the Conservatory) asserted as a defense that Sandor had acted unreasonably in refusing Strange as a tenant.[54] Following a bench trial the court found that while the Conservatory's abandonment was improper, Sandor had notice of it and was aware of the proposition for an assignment. The trial court concluded that Sandor had a duty to mitigate damages, and that its refusal of the assignment to Strange was unreasonable, and entered judgment for the defendants.[55] The trial court rejected Sandor's argument that the use clause in the lease justified the refusal to consent to the assignment. Instead the court concluded that the major purpose of such a clause was to prevent conflict between tenants and that it was not intended to limit uses where no conflict exists.[56]

Several interesting points were raised on appeal. Sandor first argued that where the lease does not contain a mandatory reletting clause, there is no duty to mitigate damages when the tenant wrongfully abandons the premises before the end of the term.[57] The court disagreed, however, pointing out that under Indiana law the landlord has a duty to attempt to relet the premises in order to mitigate damages, even when the reletting clause is permissive.[58] Sandor next argued that even if there was a duty to mitigate damages it was not required to increase its obligations under the lease by accepting an assignee with a business use inconsistent with that of the former tenant. This raised the issue of whether the use clause in the lease justified the refusal by Sandor to allow the assignment to Strange. Sandor cited *Carpenter v. Wisniewski*[59] in support of its argument.

In *Carpenter*, the landlord rejected every proposed tenant in reliance on the purpose clause limiting the use of the premises to a drug store. The court found that Sandor's conduct differed considerably from that of the landlord in *Carpenter*.[60] While Sandor at first rejected Strange on the basis of the purpose clause, it later sent letters to a variety of

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[53]*Sandor*, 498 N.E.2d at 1021-22.

[54]Additionally, the defendants claimed that Sandor's failure to repair defects in the premises acted as a constructive eviction. The trial court found no constructive eviction because the leases had been renewed despite the defects. *Id.* at 1022.

[55]*Id.*

[56]*Id.*

[57]*Sandor*, 498 N.E.2d at 1022.

[58]*See supra* notes 47-49.

[59]139 Ind. App. 325, 215 N.E.2d 882 (1966).

[60]*Sandor*, 498 N.E.2d at 1023-24.

businesses in an attempt to relet the premises, and at some point in its search for a new tenant Sandor even contacted Strange to see if he was still interested in leasing the premises. However, by this time Strange had found another location. Sandor did not contact another music store until after it had filed its complaint.[61] This conduct led the court to conclude that Sandor placed little or no reliance on the purpose clause in its search for a new tenant.[62] While the court did not raise this point, it should be noted that *Carpenter* was decided before Indiana adopted the modern contract position on the landlord's duty to mitigate damages and it is not clear that a court would allow the landlord to rely upon a use clause to refuse an otherwise qualified substitute tenant without some showing that the reliance upon the use clause was reasonable under the circumstances.

One rather interesting observation made by the court was with regard to the "primary objective" of the use clause in the lease. The court of appeals agreed with the trial court that "the 'primary objective of the purpose clause was to maintain a viable "retail" establishment in the shopping center, not necessarily to limit the activity to particular items of sale.'"[63] This conclusion was clearly supported by the evidence in the case. Sandor had sent letters to three shoe stores, a photo-development company, a muffler installer, an import company, a handicrafts shop and a tile flooring company in an attempt to relet the premises,[64] and ultimately leased the premises to Majestic Paints and the Pop Shoppe, two businesses inconsistent with the purpose clause. Sandor's managing partner stated that "you restrict the use that a particular tenant can do with his premises in order not to create conflicts among other tenants in the center," and admitted that his refusal to accept the proposed assignment to Strange was based upon a negative experience with a prior carpet store tenant. These statements support the court's conclusion that Sandor placed little significance on the use clause.[65]

The decision does not, however, suggest that the court will never give consideration to such a clause when determining the reasonableness of the landlord's refusal to accept an assignment of the lease. There are times when the defaulting tenant might be an anchor tenant and the intended use of the premises by the proposed assignee might be vital to the continued success of the center.[66] Likewise, not all tenants are

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[61]*Id.* at 1022.

[62]*Id.* at 1024.

[63]*Id.* at 1023 (citing trial court record).

[64]*Id.* At one point Sandor even recontacted Strange to see if he was still interested in leasing the premises, but by this time he had already found another location. *Id.*

[65]*Id.* at 1023-24.

[66]For a discussion of the function of anchor tenants, see *supra* note 7.

equally acceptable to the landlord because of the importance of maintaining the proper tenant mix or the image of the center.[67]

It might be useful to consider the analogous problems created by the bankruptcy of a shopping center tenant. In 1978 an amendment to the Bankruptcy Code provided that ipso facto clauses allowing the landlord to terminate the lease if the tenant filed bankruptcy were invalid.[68] This permitted the trustee of the debtor-tenant to assume or assign the unexpired lease. There was an attempt to protect landlord and other parties by providing for "adequate assurance of future performance of [the terms of the] lease."[69] Unfortunately, many bankruptcy courts either ignored or substantially modified use clauses of the debtor-tenant in shopping center leases.[70]

Recognizing that special problems existed in shopping center leases, Congress amended section 365(b)(3) of the Bankruptcy Code to provide that adequate assurance of future performance in shopping center leases includes among other things assurance that any percentage rent due under such lease will not decline substantially, that assumption or assignment of such lease is subject to all provisions such as radius, location, use or exclusionary provisions, and that assumption or assignment of such lease will not disrupt any tenant mix or balance in the shopping center. The history of the Bankruptcy Code in dealing with use clauses in shopping center leases suggests that state courts should be equally sensitive to the special problems in shopping center leases.

In this case the music store was not an anchor tenant, and there is no indication that the carpet store would adversely affect tenant mix or the image of the center, or that the volume of retail sales would substantially decrease the percentage rent in the lease, if in fact such a clause existed. However, had the original tenant been a major food store, or department store, the landlord might have been justified in invoking the use clause to find a similar business activity to replace the defaulting tenant. Even where the defaulting tenant is not an anchor tenant the need for a proper mix of tenants might justify the refusal to lease to a particular tenant even though there is no direct conflict with other existing tenant uses. One can envision a shopping center composed of a carpet store, a music store, a pet store, and a paint store, and another shopping center which includes a drug store, a novelty store, a hardware store, and a fast food restaurant. Even though none of these tenants might be considered an anchor tenant, the tenant mix

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[67]*See supra* note 4 and accompanying text.
[68]11 U.S.C. § 365(e) (1979).
[69]11 U.S.C. § 365(b)(3) (Supp. 1987).
[70]Roswick & McEvily, *supra* note 2, at 12-25.

in the latter example appears to be much more desirable. In the case at bar it does not appear from the facts that the carpet store would be less desirable than the other potential tenants contacted by Sandor and thus the court was justified in finding the refusal to allow the assignment was unreasonable. No evidence was presented by Sandor which would justify the refusal of Strange as an assignee.

II. Easements

A. *Prescriptive Easements: Element of Adverse Use*

Indiana Code section 32-5-1-1 provides for the acquisition of an easement over the land of another by adverse use. "The right of way, air, light or other easement from, in, upon, or over, the land of another, shall not be acquired by adverse use, unless such use shall have been continued uninterruptedly for twenty (20) years."[71] Indiana cases are more explicit regarding the acquisition of a prescriptive easement in Indiana.

> In order to establish the existence of a prescriptive easement across the land of another, the evidence must show an actual, hostile, open, notorious, continuous, uninterrupted, and adverse use for twenty (20) years under claim of right, or such continuous adverse use with the knowledge and acquiescence of the owner.[72]

Once the claimant establishes open and continuous use of another's land with knowledge on the part of the owner, he has made a prima facie showing of a prescriptive easement.[73]

However, this presumption may be defeated by a showing that the use was not adverse or under a claim of right.[74] The element of adverse use was raised during this survey period in *Greenco, Inc. v. May*.[75] In *Greenco*, Nancy May (May) d/b/a Monon Grill sought to establish a prescriptive easement for customers to use a parking lot on adjacent property owned by Greenco, Inc. (Greenco). Evidence established that restaurant customers had used the Greenco parking lot for 30 years.[76]

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[71]Ind. Code § 32-5-1-1 (1982).

[72]Searcy v. LaGrotte, 175 Ind. App. 498, 501, 372 N.E.2d 755, 757 (1978) (citations omitted).

[73]*Id.*; *accord* Null v. Williamson, 166 Ind. 537, 78 N.E.76 (1906).

[74]166 Ind. at 544-45, 78 N.E. at 78; 175 Ind. App. at 501-02, 372 N.E.2d at 757.

[75]506 N.E.2d 42 (Ind. Ct. App. 1987).

[76]*Id.* at 43. The Monon Grill was built in 1938, but evidence relating to the ownership and use of the property from 1938-1951 was scant. *Id.*

Prior owners of the restaurant and longtime patrons testified concerning customers' use of the parking lot. No one had paid rent to Greenco for the use of the property for parking nor was there any contract made regarding said use.[77] In the early 1980's Howard Moore (Moore), the owner of Greenco, asked for rent from the Yorks who then owned the restaurant, but they refused. May and her husband purchased the property in 1983. Moore made several attempts to obtain rent from May, and when she refused he began construction of a fence along the property line. May then paid Moore $60.00 to stop construction of the fence pending the outcome of this suit.

The trial court found that restaurant customers had used the lot for parking since 1938, that it was done with the knowledge of Greenco, that there was no agreement concerning the use of the property and that no rentals or compensation was ever paid or even a demand made until sometime in the early 1980's. The court concluded that May had met her burden of proof to establish a prescriptive easement by showing that she and her predecessors in title had exercised an actual, hostile, open, notorious, continuous, uninterrupted and adverse use under claim of right and with knowledge and acquiescence of the owner for a period of 20 years.[78] Greenco appealed.

On appeal the court noted that the party asserting the prescriptive easement may make a prima facie case by showing an open and continuous use of another's land with the owner's knowledge. This presumption, however, is rebuttable by a showing that the use was permissive or not under a claim of right.[79] In this case all of the owners of the restaurant who testified admitted that they never claimed a right to use the parking lot and there was undisputed evidence that the parking lot was shared by customers of Greenco, the Monon Grill and other members of the public. The court noted that in a similar case, *Null v. Williamson*,[80] where members of the public used a way without any direction from the owner, it was held that:

> Where a space is designedly left open by the owner, either for his own convenience or to enable his customers to resort to

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[77]*Id.* at 44. Charles Shuee, a former owner of the restaurant testified that he had made a verbal agreement with Ben Hoover, the manager of the curtain factory operated on the Greenco property, that he would put in rock and grade the parking lot, remove snow in the winter, and provide free coffee and a free lunch daily to Hoover in return for the right of restaurant customers to use the parking lot. Moore, who acquired title to the Greenco property in 1969, testified that Shuee had paid him money to maintain the parking lot. *Id.*

[78]*Id.* at 45.

[79]*Id.* at 46.

[80]Null v. Williamson, 166 Ind. 537, 78 N.E. 76 (1906).

> him, the presumption ordinarily is that a use of such space by an individual, even for his own purposes, is permissive. And the fact that a use was one which was shared with the public gives rise, in the absence of evidence to the contrary, to a presumption that it was not under an exclusive or particular claim of right.[81]

The court then concluded that while customers of the restaurant had used the parking lot since 1938, these customers, who were members of the general public, could not create a prescriptive easement on behalf of the Monon Grill. May must establish that she and her successors in interest have met the elements of a prescriptive easement. Since this was not established the court held the decision of the trial court was erroneous and the judgment was reversed.[82]

B. Concurrent Easements: Rights and Duties

In *Ashland Pipeline Co. v. Indiana Bell Telephone Co.*,[83] Ashland Pipeline Co. (Ashland) and Indiana Bell Telephone Company, Inc. (Indiana Bell) had acquired easements over the same land. Ashland acquired and recorded an easement to lay underground pipes in 1921 and sometime in the 1920's laid underground pipe along its easement which runs in a north and south direction. In 1974 Indiana Bell acquired and recorded an easement in the same area for laying underground phone cables, and in 1975 laid underground telephone cables along its easement which runs in an east-west direction. The two easements crossed in Warrick County 160 feet west of Indiana Highway 61 near the intersection of Indiana Highway 62.[84]

Indiana Bell never informed Ashland that it had laid its cable across Ashland's pipeline. In 1979 Ashland was performing routine maintenance of its pipeline when it severed Indiana Bell's cable while excavating. Bell sued for damages claiming negligence and trespass. Ashland argued that it was the duty of those who subsequently acquire a nonexclusive easement to notify concurrent easement holders so that potential problems can be avoided.[85] Ashland admitted that it did not search the county records to determine the existence of any concurrent easements, but instead relied upon a visual on-site inspection. Having observed the existence of overhead telephone lines and seeing no warnings of underground cables posted, the work crew assumed that none were present

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[81]*Id.* at 546, 78 N.E. at 78 (citations omitted).
[82]*Greenco*, 506 N.E.2d at 46.
[83]505 N.E.2d 483 (Ind. Ct. App. 1987).
[84]*Id.* at 485-86.
[85]*Id.* at 486.

and excavated, causing the severance of the underground cable. The trial court found that Ashland was lawfully upon its own easement but that the recording of the Indiana Bell easement was sufficient notice to impose a duty on Ashland to use reasonable care in excavating.[86]

On appeal Ashland argued that Indiana Bell's recording of its easement was not sufficient notice to impose any duty of care upon Ashland and that Indiana Bell was contributorily negligent in not notifying Ashland of the existence of its easement.[87] The court agreed that the rationale for the recording of an easement is to give notice to subsequent grantees, not prior grantees such as Ashland. Thus the recording of the Indiana Bell easement did not give constructive notice to Ashland.[88] The court also agreed with the trial court's conclusion that each concurrent easement holder has a right to make repairs, alterations and improvements to its easement so long as such acts do not injuriously affect his co-owners. Nevertheless the court found no duty on the part of grantees of subsequently acquired non-exclusive easements to notify prior grantees of similar easements over the same property.[89]

Having concluded that Indiana Bell had no duty to notify Ashland of the existence of its easement and that the recording of the easement by Indiana Bell did not give constructive notice to Ashland, the court addressed the issue of negligence. Ashland argued that absent notice of Indiana Bell's easement there was no duty on Ashland's part to exercise reasonable care.[90] Ashland conducted an on-site inspection, found no warning signs, consulted maps and charts to determine the location of underground pipes and cables, noticed overhead cables, and because of the custom of notifying prior easement holders assumed no underground cables were present at the site. The court rejected this argument holding "the better rule to be that it is the party who digs who bears the risk of encountering utility cables and pipes if it proceeds without consulting potentially affected services."[91] A factor which seems to have influenced the decision was the availability of a simple procedure whereby Ashland could have determined the existence or nonexistence of telephone cables in the area:

> Our review of the evidence shows that Indiana Bell had a procedure for receiving and responding to requests for locations

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[86] *Id.*

[87] *Id.*

[88] *Id.* at 487.

[89] *Id.*

[90] *Id.* at 487-88. Ashland cited Hunsberger v. Wyman, 247 Ind. 369, 373, 216 N.E.2d 345, 348 (1966) for the position that in order for an act or omission to constitute negligence a person must be charged with knowledge or notice that such an act or omission involves danger to another.

[91] *Ashland*, 505 N.E.2d at 488.

> of underground cables and received thousands of such requests yearly. Indeed there is evidence that Ashland made a request for the area in question on the date the cable was severed, but began excavating before the information was provided.[92]

While the decision does not hold that the recording of a subsequent nonexclusive easement is constructive notice to prior concurrent easement owners of its existence,[93] it does suggest that prior owners of nonexclusive easements might have a duty to search the public records for subsequent easements before making repairs.[94] In examining what constitutes reasonable care the court remarked:

> In determining reasonable care, several things may be expected of a person in order to inform himself of other rightful, concurrent, subterranean land uses, one of which may be researching recorded instruments and other public records. Other precautions may be an examination of the land itself, an inquiry of the servient estate owner, as well as a general inquiry of all utilities known to operate in the area.[95]

If one agrees with the court that the duty to determine the location and existence of concurrent easements should be placed on "the party who digs," the standard of care imposed by the court does not seem unreasonable. Nonetheless, from the standpoint of economic efficiency, the cost of notifying prior concurrent easement owners of the existence of the subsequent easement appears far less than requiring the prior owners to conduct an exhaustive and time consuming search to determine whether subsequent easements exist.

While in this case Indiana Bell provided others with a quick and inexpensive procedure for determining the existence of underground telephone cables, it is far from clear that other subsequent easement holders have similar procedures. If, on the other hand, the duty of notification were placed upon the subsequent easement holders the additional cost should be minimal, since a title search, inspection of the land and general inquiry of other potential easement holders would all be part of the normal procedure of purchasing the easement and laying underground pipes or cables.

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[92] *Id.*

[93] "Ashland correctly states that recording acts impart constructive notice only to those who claim through or under the grantor in question, and not prior grantees." *Id.* at 487.

[94] "[W]hether it investigated recorded instruments may be relevant to the steps a reasonable person would have taken, but it is neither exclusive nor exhaustive, as it would be in a question involving title." *Id.* at 488.

[95] *Id.*

III. Other Notable Cases

A. *Innkeepers: Liability for Loss or Destruction of Guests' Property*

Traditionally the liability of an innkeeper for the loss or destruction of property of guests was based on the law of bailment. The common law placed an extraordinary duty on the innkeeper which far exceeded that of the ordinary bailee for hire. He became an insurer against loss or destruction of his guests' property unless caused by the negligence of the guest, act of God or the public enemy.[96] This liability was limited, however, to property which was *infra hospitium* (within the inn or within the innkeeper's custody or control) and did not extend to property which was not within the protection of the inn.[97] Statutes in many states have reduced the extraordinary liability imposed upon innkeepers by the common law.[98] The Indiana Innkeepers' Statute, Indiana Code section 32-8-28-2, limits the liability of an innkeeper to $200.[99] In *Plant v. Howard Johnson's Motor Lodge*,[100] the Indiana Court of Appeals extended the liability of the innkeeper beyond the traditional bailee concept and at the same time removed him from the protection of the Innkeeper Statute. In *Plant*, guests' moving van and contents were stolen from the motel parking lot. The trial court found the defendant liable but limited the liability to $200 under the Innkeepers' Statute. On appeal the court noted that at common law the innkeeper was liable for property of the guest *infra hospitium* unless caused by an act of God, the public enemies or the fault of the guest.[101] However, the court also noted that by its wording the Indiana statute applies only to property "brought into such hotel, apartment hotel, or inn by any guest thereof," and since the van and its contents were never brought into the inn, the statute limiting the liability of the innkeeper to $200 did not apply.[102] The defendant

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[96] R. Brown, The Law of Personal Property § 12.15 (W. Raushenbush 3d ed. 1975).

[97] *Id.* at § 12.18. The protection did not extend to an automobile of the guest unless the inn operates a garage facility as an integral part of the hotel. *Id.* at 384.

[98] *Id.* at § 12.19.

[99] The innkeeper statute provides that the proprietor or manager of a hotel or inn shall not be liable for loss or damage to personal property (with certain exceptions not applicable to the case) "brought into such hotel, apartment hotel, or inn by any guest thereof, exceeding two hundred dollars ($200.00) in value, whether such loss or damage is occasioned by the negligence of such proprietor or manager or his agents or otherwise." Ind. Code § 32-8-28-2 (1982).

[100] 500 N.E.2d 1271 (Ind. Ct. App. 1986) *transfer denied*, 514 N.E.2d 1048 (Nov. 2, 1987).

[101] *Plant*, 500 N.E.2d at 1272-73.

[102] *Id.* at 1273.

pointed out, however, that even if the statute did not apply, it had no duty to protect the plaintiffs' property since the goods had never been delivered to the defendant for safekeeping. The parking lot was open and the plaintiffs had retained the keys to the van.

The court agreed that no bailment existed,[103] but concluded that "in modern society with its love of and dependence upon travel by motor vehicle that available parking for such vehicles is an integral and essential ingredient to establishing the relationship [between guest and innkeeper]."[104] Thus, an innkeeper has a duty to exercise ordinary care to prevent loss or damage to the vehicles of its guests. The liability of the innkeeper for vehicle contents will depend upon whether the guest has exercised reasonable care in leaving the property in the vehicle under the circumstances.[105]

B. *Sale of Homes*

1. Sale of Older Home: Fraud or Misrepresentation.—In *Lyons v. McDonald*,[106] the court found that while there was no implied warranty of habitability in the sale of an older home, the statement by the nonbuilder vendor that there were no particular problems regarding the real estate when he had actual knowledge of a termite infestation was a material representation of an existing fact upon which the buyer relied. The court found the statement was fraudulent and that the buyer could recover damages caused by the termites.[107] The court distinguished *Vetor v. Shockey*,[108] which had held the vendor was not liable for latent defects in the sale of an older home. In *Vetor* there was no showing that the defects were known to the vendor or that he had made any statements regarding the defects. The court quoted the language from *Vetor* that "[A]s for defects *known* to the vendor of an older home at the time of sale, the tort theories of misrepresentation or fraudulent concealment are alternatives open to the unknown buyer."[109]

2. Implied Warranties in Sale of Home: Integration Clause.—In *Franklin v. White*,[110] the developer of a subdivision stated to a buyer

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[103] The court noted that in order to have a bailment, the goods must be delivered to the bailee (citing Stubbs v. Hook, 467 N.E.2d 29 (Ind. Ct. App. 1984), and Weddington v. Stolkin, 122 Ind. App. 670, 106 N.E.2d 239 (1952)). *Plant*, 500 N.E.2d at 1273.

[104] *Id.* at 1274.

[105] *Id.*

[106] 501 N.E.2d 1079 (Ind. Ct. App. 1986).

[107] *Id.* at 1082.

[108] 414 N.E.2d 575 (Ind. Ct. App. 1980).

[109] 501 N.E.2d at 1081 (quoting Vetor v. Shockey, 414 N.E.2d 575, 577 (Ind. Ct. App. 1980)) (emphasis original).

[110] 493 N.E.2d 161 (Ind. 1986).

that the property was suitable for a septic tank system, which later proved untrue. The contract for sale, which was silent as to the suitability of the land for a septic tank system, contained an integration clause which provided that "all previous communications and negotiations between the parties hereto, either verbal or written, which are not herein contained, are hereby withdrawn and annulled or merged in this agreement."[111] The trial court admitted evidence of oral statements and permitted the buyer to rescind the contract on the basis of mutual mistake. The court of appeals affirmed the judgment of the trial court but did so on the additional ground that the integration clause would prohibit otherwise competent evidence and was therefore void as against public policy.[112]

The Indiana Supreme Court held that the integration clause was not against public policy and vacated the court of appeals opinion.[113] Nevertheless, the court affirmed the judgment of the trial court because the integration clause is merely probative of the intent of the parties, and the determination of whether the parties intended the writing to be totally integrated must be based on all relevant evidence. On the preliminary question of integration the court should hear all relevant evidence, parol or written.[114]

IV. Legislative Developments

This session the legislature enacted Indiana Code section 34-4-20.5 which allows a builder-vendor to give a statutory express warranty in the sale of a new residential home.[115] Section 8 of the statute provides that in selling a completed new home or in contracting to sell a new home to be completed, the builder may warrant to the initial home buyer that:

> (1) During the two (2) year period beginning on the warranty date,[116] the new home will be free from defects caused by faulty workmanship or defective materials.
>
> (2) During the two (2) year period beginning on the warranty date, the new home will be free from defects caused by faulty installation of plumbing, electrical, heating, cooling, or venti-

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[111] *Id.* at 163-64.

[112] *Id.* at 165.

[113] *Id.*

[114] *Id.* at 166-67.

[115] Ind. Code § 34-4-20.5 (Supp. 1987).

[116] The warranty date is defined in the statute as "the date of the first occupancy of the new home as a residence by the initial home buyer." Ind. Code § 34-4-20.5-7 (Supp. 1987).

> lating systems, exclusive of fixtures, appliances, or items of equipment.
>
> (3) During the four (4) year period beginning on the warranty date, the new home will be free from defects caused by faulty workmanship or defective materials in the roof or roof systems of the new home.
>
> (4) During the ten (10) year period beginning on the warranty date, the new home will be free from major structural defects.[117]

Section 8 further provides that the statutory warranties survive the passing of legal or equitable title in the home to a subsequent purchaser.[118]

One of the more interesting aspects of the statute is the duration of the new express warranties. Under the implied warranty of habitability theory in the sale of new homes recognized by case law in Indiana,[119] the statute of limitations in an action against the builder for breach of an implied warranty is ten years.[120] Under section 8 of the statute, most of the express warranties are limited to a two or four year period beginning on the date of the first occupancy of the new home as a residence by the initial home buyer.[121] Only the warranty against major structural defects[122] is provided for a full ten year period. This shortening of the warranty period greatly reduces the protection afforded to the buyer by these express statutory warranties.

Section 9 of the statute permits the builder to disclaim any implied warranties of habitability, but only if the following conditions are met:

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[117]Ind. Code § 34-4-20.5-8(a) (Supp. 1987). The statute defines a "major structural defect" as "actual damage to the load-bearing part of a new home including actual damage due to subsidence, expansion, or lateral movement of the soil affecting the load-bearing function unless the subsidence, expansion or lateral movement of the soil is caused by flood, earthquake, or some other natural disaster." Ind. Code § 34-4-20.5-3 (Supp. 1987).

[118]Ind. Code § 34-4-20.5-8(b) (Supp. 1987). This provision does not appear to change existing Indiana law. *See* Barnes v. Mac Brown & Co., 264 Ind. 227, 342 N.E.2d 619 (1976) (extending an implied warranty of habitability in the sale of a new home by a builder-vendor to a subsequent purchaser of the home).

[119]*E.g.*, Theis v. Heuer, 264 Ind. 1, 280 N.E.2d 300 (1972); Barnes v. Mac Brown & Co., 264 Ind. 227, 342 N.E.2d 619 (1976) (extending builder's implied warranty to subsequent purchaser of home).

[120]Capital Builders, Inc. v. Shipley, 439 N.E.2d 217 (Ind. Ct. App. 1982) (ten years statute of limitations governs action for negligence and breach of warranty in construction of home). Ind. Code § 34-4-20-2 (Supp. 1987) established a ten year statute of limitations in actions concerning real estate improvements.

[121]*See supra* text accompanying notes 13-14.

[122]A major structural defect is defined in the statute as "actual damage to the load-bearing part of a new home including actual damage due to subsidence, expansion, or lateral movement of the soil affecting the load-bearing function unless the subsidence, expansion, or lateral movement of the soil is caused by flood, earthquake, or some other natural disaster." Ind. Code § 34-4-20.5-3 (Supp. 1987).

(1) the warranties defined in the statute are expressly provided in the written contract between the builder and the initial home buyer; (2) the performance of the warranty obligations is backed by an insurance policy in an amount at least equal to the purchase price; (3) the builder carries completed operations products liability insurance covering liability for reasonably foreseeable consequential damages arising from defects covered by the warranties given; and (4) the disclaimer must be printed in a minimum size 10 bold face type stating that the statutory warranties are in lieu of the implied warranties that have been disclaimed by the builder, and the buyer must affirmatively acknowledge by complete signature that he has read, understands and voluntarily agrees to the disclaimer; and (5) the initial buyer must acknowledge the disclaimer of implied warranties by signing at the time of execution of the contract, a separate one page "Notice of Waiver of Implied Warranties,"[123] attached to the contract.[124]

It was not clear under what circumstances the implied warranties of habitability of a new home builder could have been waived by the initial home buyer in Indiana prior to the enactment of this statute.[125] The statute resolves this problem by setting forth the conditions under which the builder will be allowed to disclaim any implied warranties.

Section 10 of the statute provides that where the builder has provided and breached a statutory warranty, the home buyer can bring an action for damages or for specific performance against the builder.[126] If damages are awarded, the buyer can recover no more than actual damages, which means either the amount necessary to effect repair of the defect or the amount of the difference between the value of the new home without the defect and the value of the new home with the defect, reasonably

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[123]The statute provides that the disclaimer notice must include and begin with the language in the Notice of Waiver of Implied Warranty contained in section 34-4-20.5-9(b). IND. CODE § 34-4-20.5-9 (Supp. 1987).

[124]IND. CODE § 34-4-20.5-9 (Supp. 1987).

[125]There are no Indiana cases dealing with a disclaimer of an implied warranty of habitability in the sale of a new home by a builder-vendor. In states which have addressed the problem it appears the implied warranty can be disclaimed, but only by a conspicuous provision in clear and unambiguous language in the written contract between the builder-vendor and the purchaser. *E.g.*, Sloat v. Matheny Co., 625 P.2d 1031 (Colo. 1981); Hesson v. Walmsley Const. Co., 422 So.2d 943 (Fla. App. 1982); Conyers v. Molloy, 50 Ill. App. 3d. 17, 364 N.E.2d 986 (1977); Griffin v. Wheeler-Leonard & Co., 290 N.C. 185, 225 S.E.2d 557 (1976); Tyus v. Resta, 476 A.2d 427 (Pa. Super. 1984); G-W-L, Inc. v. Robichaux, 643 S.W.2d 392 (Tex. 1982); Frickel v. Sunnyside Enterprises, Inc., 725 P.2d 422 (Wash. 1986). For an argument that a disclaimer of any implied warranty of habitability in the sale of a new home by a builder-vendor should be held unconscionable and against public policy, see Hashel, *The Case of An Implied Warranty of Quality in Sale of Real Property*, 53 GEO. L.J. 633, 654 (1965).

[126]IND. CODE § 34-4-20.5-10 (Supp. 1987).

foreseeable consequential damages arising from the defect, and attorney's fees, if those fees are provided for in the written contract between the builder and the home buyer.[127] The recovery of attorney's fees by the buyer seems theoretical at best, since the standard contract drafted by the builder will seldom provide for the recovery of attorney's fees in the event of a breach of the warranty by the builder.

It is interesting to speculate whether or not the legal position of a purchaser of a new home in Indiana has been enhanced by the enactment of this statute. Perhaps the strongest argument in support of the statute is that it will encourage builders to give express warranties and to carry performance and completed operations products liability insurance in order to take advantage of the provision allowing disclaimer of implied warranties. If the statute results in more builders carrying liability insurance, this would be a major benefit to the buyer since one of the greatest dangers faced by the new home purchaser is the risk that the builder may later prove to be insolvent, preventing any recovery for the builder's breach of an express or implied warranty. Unfortunately, the statute does not require that builders carry liability insurance, and it is likely that reputable builders were already carrying such insurance before the enactment of this statute because of their potential liability under the implied warranty of habitability theory in the sale of a new home by a builder-vendor.[128] While the statute will undoubtedly result in builders expressly providing the statutory warranties in the building contract, the corresponding elimination of any implied warranties and the short duration of these express statutory warranties appear to offset any advantage to the initial home buyer.

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[127] *Id.*

[128] *See supra* note 16 and accompanying text.

Developments in Social Security Law

Theodore F. Smith, Jr.*

I. Introduction

On June 8, 1987, the Supreme Court, in *Bowen v. Yuckert*,[1] decided whether the Department of Health and Human Services' "severe impairment" regulation[2] is valid under the Social Security Act.[3] Before *Yuckert*, all eleven circuits had either ruled that the regulation is invalid or narrowed its application.[4] The Supreme Court upheld the regulation and did not narrow its application.[5]

Yuckert has important and far-reaching effects upon every American who applies for disability. This article will review the legislative, regulatory, and case law history that preceded *Yuckert*, analyze the *Yuckert* decision itself, and predict the effect *Yuckert* will have upon the disability claims process.

II. Statutory Framework

After *Yuckert* it is clear that the Secretary of the Department of Health and Human Services may consider only medical factors and refuse to consider the applicant's age, vocational background, or educational experience in order to decide that a non-working applicant is not disabled. In order to understand why this decision convoluted Congress's definition of disability, it is necessary to review the legislative and regulatory history of the Social Security Act.

When it first passed the Act in 1935, Congress did not include a disability insurance program. After several aborted attempts to enact

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*Partner, Smith and Farrell, P.C., Anderson. B.A., University of Notre Dame, 1973; J.D., Notre Dame Law School, 1976.

[1] 107 S. Ct. 2287 (1987).

[2] 20 C.F.R. § 404.1520(c) (1987).

[3] Social Security Act, Pub. L. No. 74-271, 49 Stat. 620 (1935) (codified as amended at 42 U.S.C. §§ 301-1397f (1982 and Supp. III 1985)).

[4] McDonald v. Secretary of Health & Human Servs., 795 F.2d 1118 (1st Cir. 1986); McCruter v. Bowen, 791 F.2d 1544 (11th Cir. 1986); Williamson v. Secretary of Health & Human Servs., 796 F.2d 146 (6th Cir. 1986); Brown v. Heckler, 786 F.2d 870 (8th Cir. 1986); Hansen v. Heckler, 783 F.2d 170 (10th Cir. 1986); Yuckert v. Heckler, 774 F.2d 1365 (9th Cir. 1985), *rev'd sub nom.* Bowen v. Yuckert 107 S. Ct. 2287 (1987); Johnson v. Heckler, 769 F.2d 1202 (7th Cir. 1985); Baeder v. Heckler, 768 F.2d 547 (3d Cir. 1985); Stone v. Heckler, 752 F.2d 1099 (5th Cir. 1985); Evans v. Heckler, 734 F.2d 1012 (4th Cir. 1984); Chico v. Schweiker, 710 F.2d 947 (2d Cir. 1983).

[5] Bowen v. Yuckert, 107 S. Ct. 2287 (1987).

disability provisions, Congress passed a disability freeze program in 1954.[6] This program allowed a wage-earner who was unable to work because of a "disability" to continue to be insured under the Act for a period of up to one year. This freeze was likened to a "waiver of premium" of an insurance policy. Congress defined "disability" as the "inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration . . . ."[7]

In 1956, Congress created the Federal Disability Insurance Trust Fund.[8] Under the Trust Fund, if an insured worker met the definition of disability from the 1954 Act and was at least 50 years of age or older, the worker would be entitled not only to a wage freeze, but also to a monthly benefit.[9]

In 1961, the Secretary promulgated a regulation allowing the Department to deny disability claims on the basis of medical considerations *alone*: "[M]edical considerations alone may justify a finding that the individual is not under a disability where the only impairment is a slight neurosis, slight impairment of sight or hearing, or other similar abnormality or combination of slight abnormalities."[10]

In 1965, Congress redefined disability so that the length of the disability impairment changed from "long-continued and indefinite duration" to "a continuous twelve-month period of time or result in death."[11]

By 1967, Senate data showed a rapid increase in the number of disability recipients.[12] This, as well as a handful of court decisions[13] which some viewed as an unwarranted judicial expansion of "disability," motivated Congress to further refine the definition of disability. McCormick explained this refinement as follows:

> For more than a quarter-century, disabled workers and their dependents have been provided monetary benefits under the Social Security Act. Originally, the Social Security Act defined

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[6]Social Security Amendments of 1954, Pub. L. No. 83-761, § 106, 68 Stat. 1052, 1079-81 (1954).

[7]*Id.* § 106(d), 68 Stat. at 1080.

[8]Social Security Amendments of 1956, Pub. L. No. 84-880, § 201(b), 70 Stat. 807, 820 (1956).

[9]*Id.* § 106(d), 68 Stat. at 1080.

[10]20 C.F.R. § 404.1502(a) (1961).

[11]Social Security Amendments of 1965, Pub. L. No. 89-97, §§ 108(a) 305, 329, 79 Stat. 338, 370, 400 (1965).

[12]S. Rep. No. 744, 90th Cong., 1st Sess. 46-51 *reprinted in* 1967 U.S. Code Cong. & Admin. News 2834, 2880-84.

[13]*E.g.*, Leftwich v. Gardner, 377 F.2d 287 (4th Cir. 1967).

a disabled worker, or disability, in purely medical terms, without reference to vocational factors. In 1967, however, Congress amended the statute to require explicitly that a decision as to an individual's disability take into account that person's potential for employment. According to the amended Act, which remains in force today, a claimant is to be adjudged disabled

> only if his physical or mental impairment or impairments are of such severity that he is not only unable to do his previous work but cannot, considering his age, education, and work experience, engage in any other kind of substantial gainful work which exists in the national economy.[14]

In 1968, in response to Congress's more precise definition of disability, the Secretary amended the regulations so that agency judges could consider vocational as well as medical factors:

> Whether or not an impairment in a particular case constitutes a disability . . . is determined from all facts of that case. Primary consideration is given to the severity of the individual's impairment. Consideration is also given to such other factors as the individual's age, education, training and work experience. However, medical considerations alone may justify a finding that the individual is not under a disability where the only impairment is a slight neurosis, slight impairment of sight or hearing, or similar abnormality or combination of slight abnormalities. . . .[15]

The regulation provided a "threshold" screening standard: if the claimant was unable to show more than a "slight" impairment the Department would deny his claim without considering vocational factors.

III. Implementation by the Secretary

By 1975, only 8.3 percent of the disability applications were denied because the claimed impairment was "slight."[16] As Stein and Weishaupt observed:

> In 1976, SSA also began encouraging denials under the "slight impairment" rubric. State administrators also criticized this policy on the grounds that it was subject to abuse by staff wishing to

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[14] 1 H. McCormick, Social Security Claims & Procedures § 410 at 449-50 (3d ed. 1983) (quoting 42 U.S.C.A. § 423(d)(2)(A) (1982)) (footnotes omitted).

[15] 20 C.F.R. § 404.1502(a) (1968).

[16] Stein & Weishaupt, *A Sign of the Times, or Why We Are Winning Fewer Disability Cases*, 15 Clearinghouse Rev. 24, 24 (1981).

> avoid vocational development of cases and the ensuing detailed vocational history and forms required. Use of this summary code "[r]eflects an absence of sequential analysis since the claim is prejudged to be a denial and then the absence of functional loss is ascribed."[17]

By 1978 almost one third of all denials were based on the "slight impairment" standard.[18]

In 1978, the Secretary promulgated new regulations for evaluating disability claims.[19] Under these regulations, claim evaluation is a five step process:

> *Step 1.* If the claimant "is [doing] substantial gainful activity [he is] not disabled regardless of [his] medical condition or [his] age, education, and work experience."[20] This ends the review.
>
> *Step 2.* If the claimant does not have a "severe impairment," that is, "any impairment or combination of impairments which significantly limits [his] physical or mental ability to do basic work activities," then the claimant is not disabled, and the review ends.[21]
>
> *Step 3.* If the claimant's impairment meets the duration requirements and is a listed impairment or equal to a listed impairment, then the claimant is disabled, and the review ends.[22]
>
> *Step 4.* The agency then reviews the claimant's "residual functional capacity and the physical and mental demands of the work [the claimant] ha[s] done in the past."[23] If the claimant can do this work, he is not disabled, and the review ends.
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> *Step 5.* The agency then "consider[s] [the claimant's] residual functional capacity and [his] age, education, and past work

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[17] *Id.* at 25 (quoting SUBCOMMITTEE ON SOCIAL SECURITY OF THE HOUSE COMMITTEE ON WAYS & MEANS, 96TH CONG., 1ST SESS., ACTUARIAL CONDITION OF DISABILITY INSURANCE (Comm. Print 1979)).

[18] *Id.* at 24.

[19] *See* 20 C.F.R. § 404.1520 (1987).

[20] *Id.* § 404.1520(b).

[21] *Id.* § 404.2510(c).

[22] *Id.* § 404.1520(d).

[23] *Id.* § 404.1520(e).

experience to see if [he] can do other work." If he cannot, the agency will find that he is disabled.[24]

In addition, the Secretary replaced the phrase "slight abnormality" with the phrase "severe impairment." Under the new regulation, "[a]n impairment or combination of impairments is not severe if it does not significantly limit your physical or mental ability to do basic work activities."[25] "Basic work activities" means "the abilities and aptitudes necessary to do most jobs."[26] These include:

> (1) Physical functions such as walking, standing, sitting, lifting, pushing, pulling, reaching, carrying, or handling;
> (2) Capacities for seeing, hearing, and speaking;
> (3) Understanding, carrying out, and remembering simple instructions;
> (4) Use of judgment;
> (5) Responding appropriately to supervision, co-workers and usual work situations; and
> (6) Dealing with changes in a routine work setting.[27]

The Secretary offered a reasonable purpose for the changes, an attempt to achieve "greater program efficiency" by "limiting the number of cases in which it would be necessary to follow the vocational evaluation sequences."[28] Promoting efficiency in a department that is "probably the largest adjudicative agency in the western world" is desirable. At first, at least one critic thought that the step 2 "severe impairment" standard would not change the law regarding whether the claimant has a "medically determinable physical or mental impairment."[29]

The efficiency plan worked well. By 1982, 40.3 percent of the disability claims were denied because the agency found no severe impairment.[30] This meant that of the approximately 2,300,000 claims filed in 1981,[31] agency judges were able to avoid analyzing the vocational history of approximately 1,007,500 wage-earners. This also meant that these wage-earners' applications were evaluated without regard to whether they could do their former work or other available work.

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[24]*Id.* § 404.1520(f). There is a different test for claimants who "have only a marginal education, and long work experience . . . where [the claimant] only did arduous unskilled physical labor . . . ." *Id.*

[25]*Id.* § 404.1521(a).

[26]*Id.* § 404.1521(b).

[27]*Id.*

[28]*Id.*

[29]Welch, *New Social Security Disability Regulation*, 58 MICH. B.J. 330, 331 (1979).

[30]Baeder v. Heckler, 768 F.2d 547, 552 (3d Cir. 1985).

[31]*See* Heckler v. Campbell, 461 U.S. 458, 461 n.2 (1983).

The Secretary based her justification for this policy upon three grounds: (1) her broad authority to regulate permits her to adopt the step 2 "severe impairment" requirement, (2) step 2 is necessary to promote efficiency and, (3) Congress, through the 1984 Amendment to the Act, has endorsed this sequential evaluation process.[32]

Not everyone accepted the Secretary's reasoning. Some thought it was reprehensible that the agency could find a claimant "not disabled" where the agency also found that the claimant was unable to work because of an impairment. Slowly, claimants began to challenge the validity of step 2 in the courts.

IV. Response of the Courts

In 1981, the Fifth Circuit Court of Appeals, in *Lofton v. Schweiker*,[33] criticized the step 2 practice,[34] but upheld the Secretary's decision because substantial supporting evidence existed.[35] The court also noted that the Secretary had represented that this practice was under consideration for revision.[36] The following year, Chief Judge Morton did not bury his disdain for step 2 in a footnote. In *Scruggs v. Schweiker*,[37] Judge Morton found that a 52 year old former coil winder and garment inspector, Beatrice Scruggs, was disabled under the Grids.[38] Judge Morton reversed the Appeals Council's finding of "non-severe impairment."[39] Judge Morton held that the step 2 process of the Secretary did not comply with the statutory definition of disability:

> In this case the AC arrived at step (2) . . . and found plaintiff did not have a severe impairment, and thus was not disabled. The AC terminated further consideration of the claim. One may infer that the AC concluded plaintiff could return to her previous jobs, which were coil winder, cementer in the footwear manufacturing industry, and inspector in the garment manufacturing

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[32] Johnson v. Heckler, 769 F.2d 1202, 1211 (7th Cir. 1985).

[33] 653 F.2d 215 (5th Cir. Unit A Aug. 1981).

[34] *Id.* at 217-18 n.1.

[35] *Lofton*, 653 F.2d 215.

[36] *Id.* at 217-18 n.1.

[37] 559 F.Supp. 100 (M.D. Tenn. 1982).

[38] Scruggs v. Schweiker, 559 F. Supp. 100 (M.D. Tenn. 1982). The "Grids" are the regulations at 20 C.F.R. §§ 404.1501 - 404.1599 and §§ 416.901 - 416.998. *See generally* McCormick, *supra* note 14, at § 447.

[39] *Scruggs*, 559 F.Supp 100. After the court had remanded the case for a supplemental hearing, the Administrative Law Judge found that the complainant was disabled. *Id.* at 101. The Appeals Council found that under the sequential procedures required by the regulations the claimant's impairment was not severe. Thus, "she could not be found disabled." *Id.* at 102.

> industry. But this inference in all cases may be unfair. For example, a less than severe hearing loss to an individual may prevent that individual from continuing in his present occupation requiring better hearing than the individual retains. In another example, an individual who has worked at heavy work may be restricted from continuing in heavy lifting by a less than severe muscular strain, or by some other non-severe health problem. Undoubtedly, many other examples could be conceived. Termination of sequential consideration at step (2) leaves the reviewing court with a record which is lacking a definitive finding on the issue of what job the individual can do unless it may be inferred that an individual without a severe impairment may perform at any job at any level of physical activity. This, of course, is absurd.
>
> Furthermore, the Act does not speak of a non-severe impairment, by definition or otherwise. The Act provides for consideration of clinically established impairments in relation to the individual's ability to perform a job. Section 423(d) does contain the word "severity," but in the context of determining whether the individual's impairments "are of such severity that he is not only unable to do his previous work but cannot, considering [vocational factors] engage in any other kind of [work]." Elsewhere, it is provided that impairments must be demonstrated by "clinical and laboratory diagnostic techniques." Thus, it appears Congress fully intended that the severity of clinically established impairments be considered in relation to the vocational prospects of the individual. A non-severe finding, with nothing more, does not comply with this statutory requirement.[40]

Judge Morton indicated that when future claims that have terminated at step 2 come before the court, the court will assume that had the investigation continued, the fact finder "would have found that the impairments were neither listed nor prevented the individual from returning to previous work."[41]

By 1984, several circuits found the issue of the validity of the regulation squarely before them. In that year, the Sixth Circuit Court of Appeals upheld the validity of the severity regulation.[42] The Fifth,[43] Seventh,[44] and Eleventh[45] Circuits narrowed the implementation of the

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[40]*Id.* at 103 (citations omitted).

[41]*Id.* at 104.

[42]Gist v. Secretary of Health & Human Servs., 736 F.2d 352 (6th Cir. 1984).

[43]Estron v. Heckler, 745 F.2d 340 (5th Cir. 1984).

[44]Taylor v. Schweiker, 739 F.2d 1240 (7th Cir. 1984).

[45]Brady v. Heckler, 724 F.2d 914 (11th Cir. 1984).

regulation. As the court in *Estran v. Heckler* reasoned, the non-severe impairment definition

> must be read in light of the earlier regulations defining severe impairment adopted in 1968, for, as explained by the Secretary in the Federal Register, the new terminology was intended solely to clarify, not to change, the definition of "severe impairment." The change in language was not accompanied by "an intention to alter the levels of severity for a finding of disabled or not disabled." In the 1968 regulations, non-severe impairment is described as, ". . . a slight neurosis, slight impairment of sight or hearing, or other slight abnormality or combination of abnormalities."[46]

These courts did not rule on the actual validity of the non-severe impairment; they only narrowed the implementation of the regulation to the pre-1978 regulation of "slight impairment."

In 1985 there were three important circuit court decisions. These decisions by the Third Circuit,[47] the Seventh Circuit,[48] and the Ninth Circuit[49] ruled invalid step 2 of the evaluation process.

The Third Circuit case, *Baeder v. Heckler*,[50] involved the disability claim of Paul H. Baeder, a fifty-five year old worker who had worked in a glass packing plant for nearly 30 years. By his twenty-seventh year at the plant, he began to experience constant headaches, dizziness, and difficulty moving his joints. He switched to a less demanding job at the plant. Unable to experience adequate relief from his symptoms, he retired. His treating physician opined he was totally disabled due to significant pulmonary obstructive disease, osteoarthritis, diabetes, and diabetic peripheral neuropathy. The Administrative Law Judge, using step 2, found Mr. Baeder's impairment "not severe" and denied his application.[51] The U.S. District Court for New Jersey invalidated the step 2 regulation and ordered the case remanded[52] and the Secretary appealed.

The Third Circuit upheld the district court's finding that the regulation was invalid.[53] Judge Hunter's opinion found that the regulation was inconsistent with the statute. The court rejected the Secretary's

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[46]745 F.2d at 340-41 (citations omitted).

[47]Baeder v. Heckler, 768 F.2d 547 (3d Cir. 1985).

[48]Johnson v. Heckler, 769 F.2d 1202 (7th Cir. 1985).

[49]Yuckert v. Heckler, 774 F.2d 1365 (9th Cir. 1985).

[50]768 F.2d 547 (3d Cir. 1985).

[51]*Id.* at 550.

[52]Baeder v. Heckler, 592 F.Supp. 1489 (D.N.J. 1984).

[53]*Baeder*, 768 F.2d at 553.

argument that the legislative history of the Social Security Act supports the contention that disability applicants may be rejected by medical factors alone. The court discovered that the 1954 legislative history supported the notion that disability claims must be evaluated by both medical *and* vocational factors. The court also noted that the regulation

> allows the Secretary to bypass a full-scale evaluation, which would consider and relate both medical and vocational factors, of an applicant who might actually be entitled to benefits were his age, education, and work experience considered.[54]

By way of example, the court noted in a footnote that the district court found that had Mr. Baeder's claim been evaluated by the vocational grids, there would have been a finding of disability.[55]

The Seventh Circuit Court of Appeals reviewed a class action from the Northern District of Illinois in which the district court invalidated the step 2 regulation.[56] There were two named plaintiffs. The first was Edna Johnson, a former nurses' aide who had two years of high school education. Mrs. Johnson proved at the administrative hearing by unrebutted evidence that she was unable to perform her past job due to anxiety neurosis, duodenal ulcer, Schatzki's ring of the esophagus, lumbago and diabetes mellitus. The Administrative Law Judge, considered each of her impairments separately and found that each impairment was not severe under step 2.[57]

The second named plaintiff was James Montgomery, a butcher of some 28 years whose disability benefits were terminated after having received disability benefits for six years. Mr. Montgomery had a sixth grade education. The Secretary found him disabled due to diabetes and heart condition. Six years later the Appeals Council reversed the Administrative Law Judge's finding of continuing disability, ruling that his impairments were non-severe.[58]

In a well written opinion, Circuit Judge Bauer called the Social Security Act "one of the most important and far-reaching enactments ever passed by Congress, affecting the life of almost every American."[59] After reviewing a very important part of this Act, the disability provisions,

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[54]*Id.* at 553.

[55]*Id.* n.4.

[56]Johnson v. Heckler, 769 F.2d 1202 (7th Cir. 1985), *aff'g* 593 F. Supp. 375 (N.D. Ill. 1984).

[57]769 F.2d at 1206. The Seventh Circuit noted that after December 1, 1984, the Secretary must consider the combined effect of non-severe impairments at step 2. *Id.* at 1213.

[58]*Id.* at 1206.

[59]*Id.* at 1209.

the court ruled that the step 2 non-severity regulation was invalid under the Act.[60] The court carefully reviewed the legislative history of the Act together with the comments of Congress. After this examination, the court rejected the contention of the Secretary that both the Act and its history support a denial of disability benefits on medical factors alone. The court convincingly dispelled the assertion of the Secretary that the 1984 Disability Reform Act[61] gave indirect approval of the step 2 regulation. Instead, the court found that not only was there no approbation by Congress of step 2 but there was constrained criticism by Congress of its use.[62] The Seventh Circuit repudiated the Secretary's efficiency argument as justification for her threshold requirement: "[E]fficiency arguments provide absolutely no basis for the Secretary to violate Congressional mandates to implement properly the disability benefits program of this nation."[63]

The Ninth Circuit, citing the "lack of symmetry" between the Act and the regulation, held with the Third and Seventh Circuits that the regulation was invalid.[64] Each of these three circuits reasoned that case law clearly established that once a claimant has shown his inability to perform his past relevant work the burden of proof shifts to the Secretary. The Secretary must prove, while considering the age and vocational background of the claimant, that there are jobs available in significant numbers that the claimant is capable of performing. To allow the Secretary to deny claims as "non-severe," the courts found, would permit the Secretary not to consider the age and vocational history. In addition to altering the burden of proof, the courts found that the Social Security Act simply did not require that the claimant's impairment be "severe."[65]

Notably, the courts refused to accept the invitation to narrowly construe step 2 to permit only a "*de minimus*" type of threshold assessment. The courts could find nothing in the regulation that limited the Secretary to a "*de minimus*" review. Further, the courts could not find authority in the Social Security Act allowing implementation of a threshold requirement. Perhaps a more significant factor in the courts' refusal to narrow the regulation and accept step 2 as a "*de minimus*" standard was the indiscriminate manner in which the Secretary employed step 2. As demonstrated by the facts in the Third and Seventh Circuit

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[60]*Johnson*, 769 F.2d 1202.

[61]Social Security Disability Reform Act of 1984, Pub. L. No. 98-460, 98 Stat. 1794 (1984).

[62]*Johnson*, 769 F.2d at 1212.

[63]*Id.* at 1213.

[64]Yuckert v. Heckler, 774 F.2d 1365 (9th Cir. 1985).

[65]*See supra* notes 47-49.

cases, the courts viewed the threshold argument of the Secretary incredulously.[66]

By 1986, eleven circuits had either ruled the regulation invalid or narrowed its construction so that it would only apply as a threshold standard.[67] The stage was now set for the final battleground, the Supreme Court.

V. The *Yuckert* Case

It is of no great surprise that the case chosen by the Supreme Court to review was that of a young individual (45 years old) with a high school education, two years of business college and real estate training.[68] Equally predictable was the fact that the impairments alleged by the claimant in the selected case were more subjective than objective (episodes of dizziness and vision problems). No reader should be surprised to learn that the claimant was attending a two year computer program course, drove a car 80 to 90 miles per week, and was denied her claim throughout the administrative process and at the district court level. In a five to three decision, the Supreme Court decided that the Secretary had the ability to require Janet Yuckert to make a threshold showing that her impairments were medically "severe" without regard to her age or vocational factors.[69] In support of this ruling, the Supreme Court cited the language of the Act and legislative history.

Justice Powell, who wrote the unconvincing majority decision for the divided Court, compared the statutory definition of "disability" with the definition in the regulation.[70] The Court did not begin its comparison

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[66]*See* Baeder v. Heckler, 768 F.2d 547 (3d Cir. 1985); Johnson v. Heckler, 769 F.2d 1202 (7th Cir. 1985).

[67]*See* cases cited *supra* note 4.

[68]Bowen v. Yuckert, 107 S. Ct. 2287 (1987).

[69]*Yuckert*, 107 S. Ct. 2287.

[70]This statute provides in pertinent part:

> The term "disability" means
>
> (A) inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months; or
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> (B) in the case of an individual who attained the age of 55 and is blind . . .
>
> (2) For purposes of paragraph (1)(A)-
>
> (A) An individual except a widow, surviving divorced wife, widower, or surviving divorced husband for purposes of section 402(e) or (f) of this title shall be determined to be under a disability only if his physical or mental impairment or impairments are of such severity that he is not only unable to do his previous work but cannot, considering his age, education, and work experience, engage in any other kind of substantial gainful work which exists

of the regulation with the statute by laying the statute and the step 2 regulation side by side. Rather, the Court began its comparison by first bifurcating the statute. The first part of the bifurcated statute was passed in 1954. The second part of the statute was passed in 1967. In addition to dividing the statute, the Court edited a significant portion of the 1967 amendment.[71] Having cut and spliced the statute, the Court was ready to compare.

The Court ruled that the regulation did not conflict with that portion of the Act which was passed in 1954. In fact, the Court found that the 1954 statutory scheme and the regulation were similar in their approach. That is, both the statute and the regulation dealt with "functional impairments." To support this conclusion, the Court cited a part of the legislative history accompanying the passage of the 1954 statute and found that this history anticipated the creation of a "threshold" level of review by the Secretary.[72]

Next, the Court considered Yuckert's argument that the severity regulation was inconsistent with the 1967 amendment's requirement that the Secretary consider her impairment not in a vacuum, but in relation to her age and other vocational factors to determine whether she had an impairment which prevented her from performing substantial gainful activity. Justice Powell dealt with this position by using a type of judicial sleight of hand; he quoted only the edited version of this now bifurcated statute:

> [A]n individual . . . shall be determined to be under a disability only if his physical or mental impairment or impairments are of such severity that he is not only unable to do his previous work but cannot, considering his age, education, and work experience, engage in any other kind of substantial gainful work. . .[73]

The Court said, "The words of this provision limit the Secretary's authority to grant disability benefits, not to deny them."[74]

> in the national economy, regardless of whether such work exists in the immediate area in which he lives, or whether a specific job vacancy exists for him, or whether he would be hired if he applied for work. For purposes of the preceding sentence (with respect to any individual) "work which exists in the national economy" means work which exists in significant numbers either in the regions where such individual lives or in several regions of the country. 42 U.S.C. § 423(d).

[71] *Yuckert*, 107 S. Ct. at 2294. The Court omitted the portion of the statute that says "For purposes of paragraph (1)(A)."

[72] *Id.* at 2293-94.

[73] *Id.* at 2294 (quoting Social Sec. Amendments of 1967, Pub. L. No. 90-248, §158(b), 81 Stat. 821, 868 (1968)).

[74] *Id.*

The weakness in the Court's comparison of the statute and regulation is that its version of the statute is deficient. The Court ignored the key phrase: "For purposes of paragraph (1)(A)." This phrase, written by Congress in 1967, means that the age and vocational factors are to further define the meaning of "disability." Justice Blackmun, in his dissenting opinion, wrote that a "straight forward" reading of the statute leads to the conclusion that the age and vocational factors are to be considered at the time the issue of disability is decided and not afterward.[75]

Justice Powell attempted to bolster this interpretation of the 1967 amendment by citing a portion of the 1967 legislative history. As Justice Blackmun noted in his dissent, the section of the legislative history used by the majority is incomplete.[76] Both the majority and dissent claim the legislative history favors its particular interpretation of the statute; that is, vocational factors should/should not be considered initially when deciding disability. A careful review of the 1967 history beckons the reviewers to conclude that the legislative history is at best equivocal.

Justice Powell concluded his analysis of the regulation by reference to the Social Security Disability Benefits Reform Act of 1984.[77] He found that this Act, even though it was meant as remedial legislation to aid disability recipients who had been terminated, supported the severity regulation which had been promulgated some six years earlier.[78] Ignoring the efficacy of employing legislative history made subsequent to the passage of an act, Justice Powell was incorrect to characterize the 1984 legislative history as supportive of the severity regulation.

There are three reasons why the 1984 legislative history pertaining to the Disability Reform Act cannot be construed to support the severity regulation. First, nowhere in the 1984 Act's legislative history does Congress expressly approve the step 2 regulation. Second, step 2 was criticized, not approved.[79] Third, the legislators at the time of the hearings were painfully aware of two factors. First, new legislation was being created to make review of cessation cases fairer in light of the Secretary's earlier, almost arbitrary, terminations.[80] Second, over one million constituents had been denied disability at step 2 alone in 1982.[81] These two

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[75]*Id.* at 2300-11 (Blackmun J., dissenting).

[76]*Id.* at 2302.

[77]*Id.* at 2296 (Citing Pub. L. No. 98-460, 98 Stat. 1794 (1984)).

[78]*Id.* at 2295-96.

[79]*See, e.g.*, House Comm. on Ways and Means, Social Security Disability Benefits Reform Act of 1984, H.R. Rep. No. 98-618, 98th cong., 2d Sess. 6-8, *reprinted in* 1984 U.S. Code Cong. & Admin. News 3038, 3043-46.

[80]*Id.*

[81]*Id.*

factors led Congress to view the Secretary and her regulations with, at best, caution. To assert that congressional committees, charged with overseeing the Secretary, would give blanket approval to step 2 ignores not only what was said, but also the atmosphere in which the comments were made.

Justice O'Connor filed a concurring opinion in which Justice Stevens joined.[82] Justice O'Connor felt compelled to address the issues that Yuckert and the rather large number of *amici curia* raised concerning the Secretary's implementation of step 2. Justice O'Connor found that there was evidence, unrebutted by the Secretary, that proved that the Secretary had employed the step 2 regulation "in a manner inconsistent with the statutory definition of disability."[83] Justice O'Connor concluded her opinion by stating that step 2 was only a threshold step: "Only those claimants with slight abnormalities that do not significantly limit any 'basic work activity' can be denied benefits without undertaking this vocational analysis."[84]

Justice Blackmun, joined by Justices Brennan and Marshall, dissented.[85] The dissent, written in a clear and convincing manner, expressed precisely the practical problem of allowing step 2 to exist:

> The § 423(d)(2)(A) inquiry furthers the purpose of the disability benefits program by ensuring an individualized assessment of alleged disability in cases of insured workers. The inquiry takes into account the fact that the same medically determinable impairment affects persons with different vocational characteristics differently. A relatively young, well educated, and experienced individual who can no longer perform his past work due to a medical impairment may be able to transfer his skills to another job and perform substantial gainful work. The same medical impairment may have a much greater effect on a person's ability to perform substantial gainful work if the person is of advanced age and has minimal education and limited work experience. Thus, a particular medical impairment may not be disabling for the first individual while it could be for the second.[86]

VI. Future Effects of *Yuckert*

Although it has been only a short time since the *Yuckert* decision, some experts have already expressed their opinions about its effect. Some

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[82]107 S. Ct. at 2298-2300 (O'Connor J., concurring).
[83]*Id.* at 2299.
[84]*Id.*
[85]*Id.* at 2300 (Blackmun, J., dissenting).
[86]*Id.* at 2303.

believe that whatever harm the Court created by upholding the facial validity of the regulation has been "tempered" by the convincing opinion of Justice O'Connor. Other Supreme Court observers declared that the ruling was only a "partial defeat for disability claimants." They suggested that the impact was difficult to gauge because it would depend upon how broadly the decision is interpreted by the government and lower courts.[87]

Bar predictions are optimistic, but as long as the "severe impairment" requirement exists, agency rank-and-file are free to continue to use this provision to deny claimants a full and fair evaluation.

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[87] *See* Taylor, *Justices Uphold Regulation Limiting Disability Benefits*, New York Times, June 9, 1987, at A23, col. 1.

Significant Developments in Indiana Taxation

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I. Introduction

The rapidly emerging role of the new Indiana Tax Court and Indiana's stance as to the taxability of the foreign source income of United States domestic companies again shared the limelight as significant developments in Indiana taxation during the survey period. However, closely following the prominence of these two significant state tax concerns has been the administrative establishment of the Great Lakes Interstate Sales Compact by the Indiana Revenue Department. A five-state reciprocal tax audit program, the Great Lakes Interstate Sales Compact will enable the Indiana Revenue Department to obtain from the states of Illinois, Michigan, Minnesota and Ohio tax audit information regarding possible, as well as confirmed, Indiana taxpayers. It appears that the proposed audit program will in turn require Indiana auditors to seek during their audits of Indiana taxpayers certain kinds of tax data that, while not relevant for Indiana tax purposes, could demonstrate that the taxpayer under audit also has a tax liability in any one of the other four Compact states. While commendable in its objective to shut down state tax evasion by taxpayers, particularly nonresident taxpayers that are either not reporting or are underreporting state tax liabilities to any of the members of the five-state reciprocal audit program, there is a real question whether Indiana's participation, if carried to the fullest extent apparently contemplated, would exceed the Department's statutory audit powers.

A major setback for the Revenue Department occurred during the survey period when the court of appeals in *Indiana Department of State Revenue v. Best Ever Companies, Inc.*,[1] struck down a gross income tax regulation that the Revenue Department had promulgated to curtail the availability to wholesale grocers of the "gross earnings" basis for reporting gross income tax liability. *Best Ever* will also be significant in the future as it represents once again a judicial admonition to the

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[1] 495 N.E.2d 785 (Ind. Ct. App. 1986).

state's tax agencies that their "powers are strictly limited to [their] authorizing statute."[2]

II. The Emerging Role of the Indiana Tax Court

Since its opening day in July 1986, the Indiana Tax Court has already proved itself to be an extremely capable and energetic court, resolved to examining tax issues thoroughly and rendering decisions with dispatch. In its inaugural term, the tax court issued over 20 opinions which give tax practitioners substantial direction on a broad range of Indiana tax issues.

From its early decisions, it is clear that the court perceives that it possesses broad jurisdiction over state tax matters and, very significantly, it also appears that the court may be positing its judicial role as a co-equal or near co-equal of the court of appeals. Admittedly, this latter observation may be premature and unwarranted. It is true that the tax court was statutorily established as "[a]n appellate court,"[3] but it is also true that the court of appeals is a constitutionally established court.[4] Therefore, the tax court, while denominated an "appellate court," may on its own—as it continues to develop its view of its proper jurisprudential role—assume a deferential position to the court of appeals and to the decisions of that court. Nevertheless, until this uncertainty as to the relative roles of the tax court and court of appeals is cleared up, the precedential value of existing court of appeals decisions may be clouded.[5]

A. Perfecting an Appeal From the State Tax Board—The Tax Court Rejects the Margrat Decision

In *LeSea Broadcasting Corp. v. State Board of Tax Commissioners*,[6] the tax court, declining to follow a 1982 court of appeals decision, upheld the applicability of Trial Rule 5(E) to the filing of the notice of appeal with the State Tax Board that is required by Indiana Code section 6-1.1-15-5. In doing so, the tax court affirmed its support for the view that the Trial Rules should be applied in resolving ambiguities

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[2] *Id.* at 787.

[3] Ind. Code § 33-3-5-1 (Supp. 1987).

[4] Ind. Const. art. VII, § 6.

[5] Note that appeals from tax court decisions are to be lodged directly with the supreme court and thus the court of appeals has no appellate jurisdiction as to tax court rulings. State Bd. of Tax Comm'rs v. Fraternal Order of Eagles Lodge No. 255, No. 80505-8703-TA-349 (Ind. Apr. 21, 1987) (order instructing on proper procedure in appealing tax court decisions). *See also* Ind. Code § 33-3-5-15 (Supp. 1987) (authorizing appeal of tax court decisions to the supreme court).

[6] 512 N.E.2d 506 (Ind. T.C. 1987).

in the administrative procedures set forth in the tax laws. On August 18, 1987, the Supreme Court of Indiana sustained the tax court's decision, stating that it was in "total agreement with Judge Fisher's observation in his order" and that "Judge Fisher's order is therefore approved and adopted in its entirety for the guidance of the bench and the Bar and administrative offices of this state."[7]

In *LeSea*, the operator of religious television stations was denied a property tax exemption claim by the State Board of Tax Commissioners. Notice of that denial was given by the Board on November 7, 1986. As required by the statutory procedure governing court appeals from decisions of the State Tax Board,[8] LeSea, within 45 days of being notified of the Board's decision, filed a complaint in the tax court and served the Attorney General with a copy of that complaint. However, Code section 6-1.1-15-5(c)(1) *also* requires that the taxpayer "file a written notice with the state board of tax commissioners informing the board of his intention to appeal" within 45 days after the Board gives the taxpayer notice of its final determination.[9] LeSea did not deliver its notice of appeal to the Board on December 22 (the 45th day following the date of the Board's notice denying its exemption claim) but, instead it deposited its notice of appeal in the mail to the State Tax Board on December 22 (again, the 45th day). The State Tax Board did not actually receive the notice from LeSea until December 24.

The State Tax Board sought to dismiss LeSea's complaint for lack of jurisdiction because LeSea had failed to physically deliver the required notice to the State Tax Board before the expiration of the 45th day. The Board relied upon a number of cases discussing the requirements of section 6-1.1-15-5 and, in particular, the court of appeals' 1982 decision in *Margrat, Inc., v. Indiana State Board of Tax Commissioners.*[10] *Margrat* held that, under section 6-1.1-15-5, which at that time required a notice of appeal to be filed with the State Tax Board within 30 days of a State Tax Board's determination, the mailing of such notice by the taxpayer on the 30th day was not satisfactory and that in the absence of a physical delivery of the required notice to the Board before the expiration of the appeal period, the court was without jurisdiction.[11] The court of appeals rejected the taxpayer's argument that, under the Indiana Rules of Trial Procedure,[12] his notice of appeal to the Tax

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[7]State Bd. of Tax Comm'rs. v. LeSea Broadcasting Corp., 511 N.E.2d 1009 (Ind. 1987).

[8]IND. CODE § 6-1.1-15-5 (Supp. 1987).

[9]IND. CODE § 6-1.1-15-5(c)(1),(d)(1) (Supp. 1987).

[10]448 N.E.2d 684 (Ind. Ct. App. 1982).

[11]*Id.* at 685-86.

[12]Trial Rule 5(E) of the Indiana Rules of Trial Procedure allows filing by mail. IND. R. TR. P. 5(E).

Board, which had in fact been mailed to the Board on the 30th day, had been timely filed.

The tax court did not dispute that *Margrat* was on point with the issues raised in the *LeSea* case. Instead, the tax court found the *Margrat* decision unacceptable. The court stated early in its opinion that "the legislature has made significant changes in the tax laws since *Margrat*, chief among those being the creation of the Indiana Tax Court. In view of these changes, a reexamination of the aforementioned authorities is called for."[13] The court then thoroughly discussed those court of appeals and supreme court decisions addressing the applicability of rules of trial procedure to administrative proceedings beginning with the Indiana Court of Appeals decision in *Weatherhead Co. v. State Board of Tax Commissioners*.[14] A 1972 decision, *Weatherhead* held that under section 6-1.1-15-5's predecessor which provided in part that an appeal could be made by filing a written notice with the tax board, the term "filing" meant the delivery of the paper or document in question to the proper office and its paper or document in question to the proper officer and its receipt by him.[15] In *Weatherhead*, the court of appeals also rejected the taxpayer's argument that the trial rules were applicable and thereunder filing by mail was permissible.

Two years later, the supreme court addressed a similar issue in *Ball Stores, Inc. v. State Board of Tax Commissioners*.[16] The issue in the case was how the 30-day period in section 6-1.1-15-5's predecessor was to be computed. In that case, the 30th day had fallen on a Saturday. The taxpayer had mailed the notice to the Board but it was not actually received until the Monday following the Saturday which was the 30th day. The supreme court held that Trial Rule 6(A), which provides that in computing time, if the last day is a Saturday, Sunday or holiday, the period runs on the next day that is not a Saturday, Sunday or holiday, was applicable to appeals from the State Tax Board and that because the taxpayer's notice was received on the Monday, it was timely filed.[17] The supreme court in *Ball Stores* distinguished *Weatherhead* on the basis that, in *Weatherhead*, the last day of the 30-day period was a Thursday and "the taxpayer was not prohibited from giving notice of appeal on . . . the final day of the statutory time period."[18]

In view of the supreme court's 1974 decision in *Ball Stores*, wherein the court had held that the trial rules were applicable in determining

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[13]*LeSea*, 512 N.E.2d at 506.
[14]151 Ind. App. 680, 281 N.E.2d 547 (1972).
[15]*Id.* at 687, 281 N.E.2d at 551.
[16]262 Ind. 386, 316 N.E.2d 674 (1974).
[17]*Id.* at 393, 316 N.E.2d at 677-78.
[18]*Id.* at 392, 316 N.E.2d at 677.

how the time period in Indiana Code section 6-1.1-15-5 should be computed, it certainly appeared that the taxpayer in *Margrat* had a strong argument in 1982 when the court of appeals considered in that case whether the trial rules were also applicable in determining what is a "filing" for the purpose of section 6-1.1-15-5, the statutory notice of appeal requirement. Despite the guidance provided by *Ball Stores*, the court of appeals in *Margrat* was not persuaded. The court refused to "expand upon" the *Ball Stores* decision and supported that conclusion by reference to its statement in *Wilks v. First National Bank of Mishawaka*,[19] where it had said:

> *Ball Stores, Inc.* is not to be interpreted beyond its express language that TR. 6(A) will only come into play if a statute of limitations governing administrative proceedings is silent as to the method of computation of time; no other Trial Rule, including TR. 5(E) allowing filings by mail, has yet been held by the Indiana Supreme Court to be applicable to administrative proceedings.[20]

In short, in *Margrat*, the court of appeals concluded that *Ball Stores* addressed a different issue from that presented to it and that *Weatherhead* was dispositive of the issue presented to it.

LeSea, however, was successful in convincing the new tax court to expand upon *Ball Stores*' teachings. In fact, the tax court expressly observed that "the [narrow] interpretation given to the *Ball Stores* case by the Court of Appeals" in *Margrat* "has not been universally accepted."[21] Citing Professor Harvey's criticism of the *Margrat* decision (which Professor Harvey declared to be "devoid of justice"),[22] the tax court declined to follow it and concluded that, since section 6-1.1 is silent on the method of filing, Trial Rule 5(E) would apply.[23] The court observed that most attorneys would consider the mailing of a notice to be the equivalent of filing. It further noted that the law creating the Tax Court provides for a small claims docket and that to require physical delivery of a notice of appeal to the State Tax Board by the 45th day following the Board's denial would place a highly technical requirement on small claimants, contrary to the intent of the legislature in establishing a small claims docket in the first place.[24] By the supreme court's prompt

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[19] 164 Ind. App. 156, 326 N.E.2d 827 (1975).

[20] *Id.* at 162, 326 N.E.2d at 831 (citations and footnote omitted).

[21] LeSea Broadcasting Corp. v. State Bd. of Tax Comm'rs, 512 N.E.2d 506, 508 (Ind. T.C. 1987).

[22] 1 W. Harvey, Indiana Practice § 6.2, at 336 (2d ed. 1987).

[23] 512 N.E.2d at 509.

[24] *Id.*

affirmation of the *LeSea* decision, taxpayers have been given definitive guidance on the meaning of "filing" under section 6-1.1-15-5. However, the *LeSea* decision certainly does not resolve the many other procedural questions facing tax counsel practicing before or appealing from the State Tax Board. For example, does the three extra day rule in Trial Rule 6(E)[25] apply because the State Tax Board gives the taxpayer notice of its final determination by mail or does the mailing of a notice to the taxpayer start the 45-day appeal period running?

The *Wilks-Margrat* view, which resulted in the Trial Rules being applicable on a piecemeal basis (i.e., Rule 6(A) applies; Rule 5(E) does not) gave little comfort to a taxpayer trying to perfect a tax case appeal. Conversely, it is questionable whether the *Ball Stores-LeSea* position will do any better. Neither *Ball Stores* nor *LeSea* makes the Trial Rules applicable to all proceedings before administrative agencies. Instead they recognize that there are "a variety of instances (where) the Trial Rules do apply to parts of law practice before the Indiana Administrative agencies."[26] But if it is still the job of the courts to "make the distinctions" and "develop the applications of the Trial Rules,"[27] taxpayers will remain in a somewhat precarious position, being forced to wait for the tax court or supreme court to provide case-by-case direction on when the Trial Rules are applicable and when they are not. It required three cases on the meaning of "filing" under section 6-1.1-15-5 to arrive at an answer.

In sum, the taxpayer and his counsel now know that with respect to the required notice of the taxpayer's appeal, the mailing of that notice to the State Tax Board on or before the 45th day will satisfy section 6-1.1-15-5 and that if the 45th day falls on a Saturday, Sunday or holiday, the next succeeding business day will be the last day to file that notice. But, with respect to *all other procedures*, the taxpayer and his counsel are advised to be extremely conservative, giving the Indiana state tax agencies no opportunity to object. Finally, as preliminarily discussed, the tax court's rejection in *LeSea* of the court of appeal's holding in *Margrat* may be a strong hint that the tax court will not feel circumscribed by existing court of appeals' opinions with which it disagrees. Whether this hint becomes a reality is at this moment conjectural, however, since the court referenced changed circumstances in rejecting *Margrat*.[28]

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[25]*See* IND. R. TR. P. 6(E).

[26]1 W. HARVEY, INDIANA PRACTICE § 5.3, at 320 (2d ed. 1987).

[27]*Id.*

[28]512 N.E.2d at 506.

B. Appealing a Denial of a Property Tax Refund Claim—The Tax Court Claims Exclusive Jurisdiction

The tax court also dealt with an issue raised in last year's Survey, namely, does the tax court have jurisdiction over appeals from the denial of a property tax refund claim by a county board of tax commissioners? The tax court concluded in *Herff Jones, Inc. v. State Board of Tax Commissioners*[29] that it does have exclusive jurisdiction over such appeals.

To understand the *Herff Jones* case, one must go back to the 1985 Act creating the tax court[30] and to the general property tax laws.[31] Indiana Code section 33-3-5-2, as added by the Tax Court Act, provides "[T]he tax court has exclusive jurisdiction over any case that arises under the tax laws of this state and that is an initial appeal of a final determination made by" the Indiana Department of Revenue or the Indiana State Board of Tax Commissioners.[32] While the Act describes the court as a "court of limited jurisdiction" and yet also as a court that has "exclusive jurisdiction over any case that arises under the tax laws of this state," the court's so-called "exclusive jurisdiction" is expressly limited to appeals of a "final determination" of the State Tax Board.[33] Consequently, the pivotal jurisdictional question is whether the matter at issue represents a "final determination" by the State Tax Board. To answer that question, one must understand the nature of the remedies afforded property taxpayers under the general property tax laws.

Under the general property tax laws, a property taxpayer actually has several statutory remedies for challenging property tax liability. For example, a taxpayer may employ an assessment appeal procedure which permits a taxpayer to challenge the assessed valuation of his property.[34] Also, a correction of errors procedure permits a taxpayer to petition either local assessing officials or the State Tax Board to correct certain kinds of errors that affect the validity of the taxpayer's assessed tax liability.[35] Finally, a tax refund procedure exists that permits a taxpayer who has paid an erroneous property tax to file a refund claim to obtain a refund of the wrongful tax.[36]

The jurisdictional question in *Herff Jones* was complicated by the fact that the taxpayer, at the insistence of a county auditor, had filed

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[29]512 N.E.2d 485 (Ind. T.C. 1987).
[30]Tax Court Act of 1985, Pub. L. No. 291-1985, 1985 Ind. Acts 2278.
[31]IND. CODE § 6-1.1 (Supp. 1987).
[32]IND. CODE § 33-3-5-2 (Supp. 1987).
[33]IND. CODE § 33-3-5-2 (Supp. 1987).
[34]IND. CODE § 6-1.1-15-1 (Supp. 1987).
[35]IND. CODE § 6-1.1-15-12 (Supp. 1987).
[36]IND. CODE § 6-1.1-26-1 (Supp. 1987).

both a petition to correct errors and a refund claim. Unfortunately, these two statutory procedures are separate and independent procedures that culminate in a "final determination" by different tax officials and should not, therefore, have been combined. For example, under the correction of errors procedure, a taxpayer may petition a county auditor to correct the taxpayer's tax duplicate (the tax bill) if the auditor finds that:

> (1) The description of the real property was in error.
> (2) The assessment was against the wrong person.
> (3) Taxes on the same property were charged more than one (1) time in the same year.
> (4) There was a mathematical error in computing the taxes or penalties on the taxes.
> (5) There was an error in carrying delinquent taxes forward from one (1) tax duplicate to another.
> (6) The taxes, as a matter of law, were illegal.
> (7) There was a mathematical error in computing an assessment.
> (8) Through an error of omission by any state or county officer the taxpayer was not given credit for an exemption or deduction permitted by law.[37]

A taxpayer who desires a county auditor to take such action files a Form 133, a Petition for Correction of Errors. If the alleged error is (6), (7) or (8) above, the auditor may not make a correction without first obtaining State Tax Board approval if the challenged tax is based on an assessment determined by the State Tax Board, or the requested correction is not approved by two of the following officials: the township assessor, the county auditor, the county treasurer or the county assessor.[38]

As previously observed, *independent* of the correction of errors procedure under Indiana Code section 6-1.1-15, a taxpayer may file a claim under Indiana Code section 6-1.1-26-1 for a refund of all or a portion of property taxes paid. The claim is made on a Form 17-T. Indiana Code section 6-1.1-26-1 establishes the following three grounds upon which a refund claim may be based:

> (i) Taxes on the same property have been assessed and paid more than once for the same year;
> (ii) The taxes, as a matter of law, were illegal; or
> (iii) There was a mathematical error either in the computation

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[37] IND. CODE § 6-1.1-15-12(a) (Supp. 1987).
[38] IND. CODE § 6-1.1-15-12(d) (Supp. 1987).

> of the assessment upon which the taxes were based or in the computation of the taxes.[39]

While Indiana Code section 6-1.1-26-4 does provide that the board of commissioners shall disallow a refund claim if the claim has been disapproved by the State Tax Board, it also further expressly provides a refund claim shall be submitted to "the *county board of commissioners* for *final review*,"[40] thus vesting the *county board of commissioners* (*not* the State Tax Board) with the authority to take the final administrative step in the allowance or disallowance of a property tax refund claim.

Against this statutory background, Herff Jones filed a Petition for Correction of Errors with the Marion County Auditor. In the first printed line of the Form 133, wherein the claimant "hereby petitions for correction of an error," Herff Jones inserted the words "and a refund (per attached form 17-T)."[41] The Petition was disapproved by the township assessor, county assessor, county auditor and county treasurer and thus was sent to the State Tax Board for a final determination. The State Tax Board denied the Petition for Correction of Errors, adding in the last sentence that it also disapproved the taxpayer's claim for refund.[42] Because the plaintiff appealed in both the county circuit court[43] and the Indiana Tax Court, the State filed a petition for the tax court to exert its exclusive jurisdiction in the case. The court's disposition of that motion set the stage for the tax court's determination that it has exclusive jurisdiction of the denial of property tax refund claims.

In deciding the State's motion that the court exert its exclusive jurisdiction, the first question considered by the court was whether the State Tax Board had acted under section 6-1.1-15-12 to deny a Petition for Correction of Errors *or* under section 6-1.1-26-4 to deny a claim for refund. Based upon the record in this case, the court concluded that the action of the State Tax Board was a denial of a Petition for Correction of Errors under Indiana Code 6-1.1-15-12 and that it was unquestionable that the tax court had exclusive jurisdiction over this matter as an appeal from a final determination of the State Tax Board.[44]

Two observations should be made regarding this part of the *Herff Jones* decision. First, there are instances where a Petition for Correction of Errors would not be reviewed or acted upon by the State Tax Board.

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[39] IND. CODE § 6-1.1-26-1 (Supp. 1987).

[40] IND. CODE § 6-1.1-26-4 (1982) (emphasis added).

[41] Herff Jones, Inc. v. State Bd. of Tax Comm'rs, 512 N.E.2d 485, 488 (Ind. T.C. 1987).

[42] *Id.*

[43] A denial of a claim for refund may be appealed to the county circuit court as will be discussed below. IND. CODE § 6-1.1-26-4 (1982).

[44] *Herff Jones*, 512 N.E.2d at 489.

Reasons (1)-(5) do not require State Tax Board approval or intervention.[45] Technically speaking, the tax court would not have jurisdiction over these claims brought under section 6-1.1-15-12.[46] Second, in reaching its decision on this point, the court stated that "indeed it would seem that a claim for refund would not even lie until the error was corrected" under section 6-1.1-26-4.[47] If, by this, the court is saying that a correction of errors is required before a refund can be made under section 6-1.1-26-4, it is submitted that this interpretation is faulty. The better interpretation of these two statutory provisions is that the correction of errors procedure under Indiana Code section 6-1.1-15 is totally independent from the refund procedure under section 6-1.1-26. Both of these procedures are creatures of the 1919 Property Tax Code. As first enacted in 1919, the correction of errors procedure actually contemplated that it would be the county auditor—not the taxpayer—who would initiate a correction of errors[48] and indeed the current statutory correction of errors procedure makes no provision for a taxpayer to initiate a correction of errors.[49] Conversely, the 1919 refund procedure expressly provided that the refund procedure was to be initiated by the taxpayer, by presenting to the Board of Commissioners proof that the taxpayer had paid wrongfully assessed tax.[50]

In sum, dating back to their original enactment in 1919, these two procedures have performed different functions and have been and are today independent remedies for the wrongful assessment of tax. Indeed, the independent correction of errors procedure was separately recodified in the Property Assessment Act of 1961[51] and the unrelated refund procedure was later recodified in the Property Tax Collection Act of 1963.[52] It is accordingly submitted that the tax court's apparent suggestion that the correction of errors procedure and the refund procedure to review the State Tax Board's "final determination" to deny the taxpayer's

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[45]*See supra* text accompanying notes 37-38.

[46]*See* Ind. Code § 33-3-5-2 (Supp. 1987).

[47]*Herff Jones*, 512 N.E.2d at 489.

[48]Property Tax Code of 1919, ch. 59, § 209, 1919 Ind. Acts (current version at Ind. Code § 6-1.1-15-12 (Supp. 1987).

[49]Ind. Code § 6-1.1-15-12 (Supp. 1987).

[50]Property Tax Code of 1919, ch. 59, §§ 332-34, 1919 Ind. Acts (current version at Ind. Code §6-1.1-26 (1982 & Supp. 1987)).

[51]Property Assessment Act of 1961, ch. 319, § 1208, 1961 Ind. Acts 893 (current version at Ind. Code § 6-1.1-15-12 (Supp. 1987)).

[52]Property Tax Collection Act of 1963, ch. 280, §§ 801-03, 1963 Ind. Acts 280 (current version at Ind. Code § 6-1.1-26 (1982 & Supp. 1987)).

petition to correct errors, the court went further and assumed *that even if this had been a denial of a refund claim under section 6-1.1-26-4*, the tax court would have had exclusive jurisdiction.[53] This conclusion is clearly debatable.

First, it must be observed that section 6-1.1-26-4 provides that if the county board disallows a claim, the claimant may appeal that decision to the county circuit court.[54] The Act which created the tax court and expressly substituted the "tax court" as the court to which certain statutory appeals on tax matters were to be taken, did not amend section 6-1.1-26-4 to substitute the "tax court" for the "county circuit court."[55] Neither did the 1986 or 1987 legislature see fit to so amend section 6-1.1-26-4. Thus, because a decision on a claim for refund is not a final determination by the State Tax Board,[56] and because section 6-1.1-26-4 expressly states that denials of refund claims may be appealed to the county circuit court, it appears that the tax court does not have jurisdiction over property tax refund claim denials.

Interestingly, the court did recognize that House Bill 1861 (the act which established the tax court) initially amended Indiana Code section 6-1.1-26-4 to substitute the tax court for the circuit court and that this amendment was deleted upon the recommendation of the Committee on Courts and the Criminal Code.[57] However, the court rejected the taxpayer's argument that this legislative history required the court to conclude that all appeals from refund claim denials should be taken to the county circuit court. Instead, the tax court made an effort to reconcile the wording of section 6-1.1-26-4 with the "assumption that decisions made by the State Board on the refund claims would be reviewable by the Tax Court."[58] The court reconciled these two contradictory positions by concluding that "the Legislature understood statute 26-4(c) to address only those appeals in which the county board has discretion to allow or disallow the claim" and that the circuit court retains jurisdiction of appeals when the disagreement is of a purely local nature, "being between the taxpayer and his local county board, without any decisive input from the State Board."[59] The court then provided the following two examples:

> For example, where the State Board approves a refund claim under statute 26-2, but the county board ultimately disallows

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[53]Herff Jones, Inc. v. State Bd. of Tax Comm'rs., 512 N.E.2d 485, 491 (Ind. T.C. 1987).

[54]Ind. Code § 6-1.1-26-4 (1982).

[55]Tax Court Act of 1985, Pub. L. No. 291-1985, 1985 Ind. Acts 2278.

[56]*See supra* note 40 and accompanying text.

[57]512 N.E.2d at 490.

[58]*Id.*

[59]*Id.*

> the claim under statute 26-4(c), the county board's decision is discretionary and therefore appealable to the circuit court under this interpretation of statute 26-4(c), even though the State Board has been involved in the decision process and was responsible for the disputed assessment in the first place. However, it is not the State Board with whom the taxpayer disagrees but the county board so it makes sense that the circuit court would hear the appeal. The same kind of situation would occur where the county board initially disapproves a claim under statute 26-3(a), the State Board reviews and approves the claim on appeal under statute 26-3(b), and then the county board opts to disallow the claim on final review under statute 26-4(c). Once again, despite the State Board's involvement, the real disagreement is between the local county board and the taxpayer.[60]

The court also opted to apply the fundamental rule of statutory construction that "if a statute is susceptible to more than one interpretation, then the court may consider the consequences of a particular construction."[61] What obviously bothered the court most was that, if the tax court did not have exclusive jurisdiction over appeals from refund claims, all appeals involving refund claims under section 6-1.1-26-4 are within the jurisdiction of the county circuit courts. "A panoply of significant tax questions would be subject to resolution by ninety-one separate circuit courts in the state."[62] The court concluded that it was "difficult to believe that this result was intended when House Bill 1861 was amended to delete references to the tax court under statute 26-4(c), since consolidation of such cases was clearly the purpose of the act."[63]

It is surmised that a strong influence on the court's thinking was that to find otherwise would permit a taxpayer to completely bypass the tax court by paying the tax and appealing under section 6-1.1-26-4 to the circuit court. The court was obviously concerned that such forum shopping would undermine the objective of having the tax court have exclusive authority to hear and resolve all tax matters. It is respectfully submitted that while the court's support of that objective is most laudable, it required the court to turn its back completely on the clear and unambiguous language of Indiana Code section 6-1.1-26-4 to reach the conclusion that the tax court, not the circuit court, would have exclusive jurisdiction over the denial of a refund claim. In these authors' opinion, the better legal argument in *Herff Jones* as to the jurisdiction of the

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[60] *Id.*
[61] *Id.* at 490-91.
[62] *Id.* at 491.
[63] *Id.*

tax court in refund cases was espoused by the taxpayer who simply relied upon the clear directive of section 6-1.1-26-4 that the appeal should be brought in the circuit court.

The authors understand that *Herff Jones* has been settled and that the tax court's decision will not be appealed. If the authors are correct in their belief that a decision to deny a refund claim is not a final determination of the State Tax Board so as to vest the tax court with jurisdiction, taxpayers are faced with a real dilemma as to how and where to file their court appeals of refund claim denials. It is suggested that the most appropriate remedy would be for the legislature to enact corrective legislation eliminating any doubt as to whether the tax court has jurisdiction over property tax refund denials. In the absence of such legislative clarification, taxpayers may be well advised to file duplicate actions in both the tax court and the local county court having venue jurisdiction.

C. The Tax Court's Injunction Powers—Interpretation and Utilization

The tax court is given the authority to enjoin the collection of tax pending the original tax appeal.[64] However, the tax court may enjoin the collection of tax only if it finds that *all* three of the following criteria are met:

(1) The issues raised by the original tax appeal are substantial;
(2) The petitioner has a reasonable opportunity to prevail in the original tax appeal; and
(3) The equitable considerations favoring the enjoining of the collection of the tax outweigh the state's interests in collecting the tax pending the original tax appeal.[65]

In this survey period, we were given several decisions that illustrate how the tax court is going to interpret and utilize its injunction powers.

In *R.H. Marlin v. Indiana Department of Revenue*,[66] the petitioner sought to enjoin the collection of Indiana special fuel (diesel) tax pending the appeal of an assessment of such tax. The Department introduced evidence that the petitioner had for Indiana Motor Carrier Fuel Tax purposes reported "0" miles traveled by vehicles subject to the Motor Carrier Fuel Tax, but that in fact diesel fuel had been used in vehicles traveling on the road (and thus was subject to the Motor Carrier Fuel Tax) during the period for which these reports were filed. The petitioner

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[64] IND. CODE § 33-3-5-11(c) (Supp. 1987).
[65] *Id.*
[66] 512 N.E.2d 475 (Ind. T.C. 1986).

argued that it should be relieved from paying the special fuel tax until its appeal had been heard. The court, however, disagreed, stating:

> For the Plaintiff to receive a preliminary injunction as prayed for, it has the burden of proving by a preponderance of the evidence that the injury to it would be certain and irreparable. That it has not done. The Plaintiff at best has shown that it will be a hardship for the tax to be paid or for the injunction not to be issued but this is not sufficient. Since the failure to pay the tax is not because the Plaintiff is unable to do so but "a matter of principle", the tax could be paid.[67]

The court then went on to apply equity's "clean hands" doctrine and concluded that the petitioner in this instance did not come before the court with clean hands. The court said:

> An action seeking a preliminary injunction is an action at equity in which the principles of equity apply. One of the principles which applies is "he who comes into equity must come with clean hands." This means that equity refuses to lend its aid in any matter to one seeking its active interposition, who has been guilty of unlawful or inequitable conduct in the matter with relation to which he seeks relief.[68]

The court found that because the petitioner had reported zero miles of on-road travel for Motor Carrier Fuel Tax purposes when in fact it did have miles traveled on-road, the petitioner did not come before the court with clean hands and thus was not entitled to an injunction.[69]

It should be observed that it is not clear from the decision whether the court was apprised that the special fuel tax[70] (the subject of the appeal) and the Motor Carrier Fuel Tax[71] (the tax with respect to which the petitioner was shown to have misreported) are *entirely separate taxes* with separate reporting obligations, etc.. While the conclusion that the petitioner had "unclean hands" may have been justified in *Marlin* because both taxes (that being challenged and that with respect to which the petitioner had misreported) related to fuel consumption, it is certainly arguable that taxpayers should not be required to establish that with respect to other taxes (unrelated to the appeal) it has satisfied all reporting obligations. The court itself in *Marlin* said "equity refuses to lend its aid in any matter to one seeking its active interposition, who has been

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[67] *Id.*
[68] *Id.*
[69] *Id.* at 475-76.
[70] IND. CODE § 6-6-2.1 (Supp. 1987).
[71] IND. CODE § 6-6-4.1 (Supp. 1987).

guilty of unlawful or inequitable conduct *in the matter with relation to which he seeks relief.*"[72]

In *Faris Mailing, Inc. v. Indiana Department of State Revenue*,[73] the tax court declared that since the petitioner was not going to suffer irreparable harm if the injunction was not issued and since the petitioner did not have a reasonable opportunity to prevail on the merits, an injunction would not be issued. Faris Mailing sought an injunction against the collection of sales and use tax and gross income tax pending its appeal to the tax court. The court refused to accept the taxpayer's argument that it would suffer irreparable harm just because it had cash flow problems that made it difficult to pay the tax. The court observed that the taxpayer could borrow the funds necessary to pay the tax because its "ratio of current assets to current liabilities is favorable; the Petitioner is not carrying an overly large load of long-term debt; the assets appear to be more than sufficient to provide a basis for securing additional debt."[74] The court then concluded that the taxpayer's inability to pay the disputed taxes was due to its "own inaction" in not obtaining borrowed funds to meet its obligations.[75]

Marlin and *Faris* are significant because "irreparable harm" is not one of the three criteria listed in Indiana Code section 33-3-5-11.[76] Although the parties to the *Faris* case said nothing about this point, the court itself raised it, noting that "[i]t has been suggested, at least, that a taxpayer has always had the ability to obtain an injunction where irreparable harm would ensue if the tax had to be paid in order to gain access to the courts and thus *additional* grounds for obtaining an injunction were given in IC 33-3-5-11."[77] The court went on to find that the taxpayer did not have a reasonable opportunity to prevail on the merits.[78] After *Faris*, one could conclude that if a taxpayer cannot prove irreparable harm, it may still be entitled to an injunction if it satisfies all three requirements under section 33-3-5-11. Conversely, the tax court also may be open to the argument that even if a taxpayer cannot meet the requirements of section 33-3-5-11, it may still be able to obtain an injunction where irreparable harm would "ensue if the tax had to be paid in order to gain access to the courts."[79] Tax counsel seeking an injunction should thus be prepared to argue both that their client will

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[72]*Marlin*, 512 N.E.2d at 475 (emphasis added).

[73]512 N.E.2d 480 (Ind. T.C. 1987).

[74]*Id.* at 482.

[75]*Id.*

[76]*See supra* text accompanying notes 64-65.

[77]*Id.* (emphasis added).

[78]*Faris*, 512 N.E.2d at 483-84.

[79]*Id.* at 482.

suffer irreparable harm *and* that all three criteria of section 33-3-5-11 are met.

In *Video Tape Exchange Coop of America v. Indiana Department of State Revenue*,[80] the tax court issued an injunction after finding the taxpayer satisfied all three requirements of section 33-3-5-11. The issue in this case was whether Indiana sales tax was properly due on the rental of video tapes. The court found this to be a *substantial issue* with statewide impact, thus fulfilling the requirement of Indiana Code section 33-3-5-11(c)(1).[81] The court also found that the equitable considerations favoring the enjoining of the collection of the tax outweighed the state's interest in collecting the tax. The court reached this conclusion in part because the petitioner had relied upon information received from the Department of Revenue in not collecting the tax, *and* the Department itself had refrained from taking steps to collect the tax from the petitioner.[82] Thus, the requirement of section 33-3-5-11(c)(3) was fulfilled.[83]

The court then devoted the rest of its opinion to the requirement of section 33-3-5-11(c)(2)[84] that the petitioner have a reasonable chance of success in its original tax appeal. The court defined the term "reasonable" as used in section 33-3-5-11(c)(2) as meaning "moderate," "tolerable," "rational," "honest" or "equitable."[85] The court then concluded that the issue in this case turned on the meaning of the word "broadcast" in Indiana Code section 6-2.5-4-10(c)(2) which exempts from sales tax the rental of video tapes by persons who broadcast the tape for home viewing or listening and that "the issue should be resolved in favor of the Petitioner."[86]

III. Gross Earnings Treatment—The Revenue Department's Definition of a Wholesale Grocer is Held Invalid

In *Indiana Department of Revenue v. Best Ever Companies, Inc.*,[87] the Revenue Department's regulation defining a wholesale grocer as a taxpayer "engaged in the business of purchasing grocery stocks . . . from another for resale in substantively unchanged form to retail food establishments"[88] was struck down as being contrary to law and hence invalid. As a result, many taxpayers in Indiana may now want to reassess

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[80]512 N.E.2d 476 (Ind. T.C. 1986).
[81]*Id.* at 477.
[82]*Id.*
[83]*See supra* text accompanying note 65.
[84]*Id.*
[85]*Video Tape Exchange*, 512 N.E.2d at 477.
[86]*Id.*
[87]495 N.E.2d 785 (Ind. Ct. App. 1986).
[88]Ind. Admin. Code tit. 45, r. 1-1-77 (1984).

whether they qualify for the more favorable wholesale grocer treatment under the Gross Income Tax Act.

The Indiana gross income tax is just that—a tax imposed upon the total gross receipts of the taxpayer without any deductions of any kind. Shortly after the enactment of the Gross Income Tax Act in 1933, it became apparent that it was particularly harsh on those businesses that operated on a very narrow margin, e.g., wholesale grocers, grain dealers, domestic casualty and fire insurance carriers, financial institutions, and brokers. As a result, the legislature enacted a series of special amendments to the Gross Income Tax Act that allowed some of these businesses to pay on what was called a gross earnings basis. In the case of a wholesale grocer, this meant that the tax base was its gross receipts *less* cost of goods sold and other related expenses. Specifically, the Gross Income Tax Act allows a wholesale grocer that is "engaged in the business of selling stocks of groceries" to calculate its taxes based on its gross earnings which "are derived from *wholesale sales* of stocks of groceries . . . to retail food establishments."[89] "Wholesale sales" as defined in the statute include "sales of tangible personal property . . . for resale in the form in which it was purchased."[90]

In 1978, however, the Revenue Department adopted new gross income tax regulations which defined a "wholesale grocer" as a taxpayer who is "engaged in the business of purchasing grocery stocks . . . from another for resale in *substantively* unchanged form to retail food establishments."[91] Following a protest hearing, the Department of Revenue had issued a Letter of Findings concluding that Best Ever, a dairy operation, was not a wholesale grocer because it processed raw milk into homogenized milk, cottage cheese, ice cream, and half-and-half and, therefore, did not sell its product in "*substantially* unchanged form."[92] Best Ever filed an appeal. Although a good portion of the trial was devoted to whether the term "substantively unchanged form" as used in the regulation was the same as "substantially unchanged form," as the Department had stated in its Letter of Findings, the court of appeals avoided that issue altogether by simply finding the regulation invalid.[93]

The court found the Department's regulation was inconsistent with the Gross Income Tax Act in two respects. First, it sought to require that the taxpayer claiming to be a wholesale grocer purchase grocery stocks (*i.e.*, finished grocery products). The court of appeals rejected this aspect of the regulation because the Gross Income Tax Act puts

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[89] IND. CODE § 6-2.1-1-4 (1982) (emphasis added).

[90] IND. CODE § 6-2.1-2-1(c)(1)(A) (1982 & Supp. 1987).

[91] IND. ADMIN. CODE tit. 45, r. 1-1-77 (1984) (emphasis added).

[92] 495 N.E.2d at 786 (emphasis added).

[93] *Id.* at 788.

no limitations on the wholesale grocer's purchases.[94] Second, the regulation sought to require the taxpayer, to be a wholesale grocer, to sell its goods in substantively unchanged form. Clearly, under the Act itself, *it is the wholesale grocer's customer, not the wholesale grocer*, that must resell the goods in the same form. The court said:

> Under the pertinent provisions of the Act, a taxpayer that is engaged in the business of selling stocks of groceries may calculate its taxes based on its gross earnings derived from sales of stocks of groceries to a retail food establishment if the *retailer* purchased the grocery stocks for the purpose of reselling them in the form in which it purchased them. The Act thus looks to the identity and intentions of the *purchaser* at the moment of the sale to determine the character of the sale and, consequently, the method of calculating the taxpayer's gross income taxes. The Act says nothing about where or how the taxpayer acquired the grocery stocks or what it did with them prior to the sale to a retail food establishment.[95]

In rejecting the Department's attempt to narrowly define the term "wholesale grocer" by regulation, the court of appeals reminded the Department again that it is an administrative agency and, as such, "[i]ts powers are strictly limited to its authorizing statute"[96] and *"it may not by its rules and regulations add to or detract from the law as enacted."*[97]

The *Best Ever* case represents another defeat for the Revenue Department in its efforts to administratively restrict the availability of the gross earnings treatment. Having lost *Indiana Department of State Revenue v. Stark-Wetzel*[98] and *Indiana Department of State Revenue v. Food Marketing Corp.*,[99] it is anticipated the Revenue Department will now abandon its efforts to interpret the gross earnings provision of the Gross Income Tax Act narrowly. The court in *Best Ever* has certainly again informed the Department that it will not tolerate efforts by the Department to constrain by rule or regulation the scope of the wholesale grocers provision.

IV. The New Foreign Dividend Deduction

The 1987 Session of the General Assembly resolved an inequity created by its adoption in 1985 of the so-called Sony Amendment[100]

[94]*Id.*

[95]*Id.*.

[96]*Id.* at 787 (citing Van Allen v. State, 467 N.E.2d 1210 (Ind. Ct. App. 1984)).

[97]*Id.* (quoting Indiana Dept. of State Revenue v. Colpaert Reality Corp., 231 Ind. 463, 479-80, 109 N.E.2d 415, 422-23 (1952)) (emphasis added by court of appeals).

[98]150 Ind. App. 344, 276 N.E.2d 904 (1971).

[99]403 N.E.2d 1093 (Ind. Ct. App. 1980).

[100]Sony Amendment, Pub. L. No. 75-1985, 1985 Ind. Acts 658.

which prohibited the Indiana Department of Revenue from applying the unitary business theory to combine an Indiana adjusted gross income taxpayer with a foreign corporation or foreign operating corporation. This amendment confirmed, as Governor Orr had assured the Sony Corporation and other foreign business investors in 1984, that Indiana was not a unitary state and that it would not seek to combine the income of a foreign parent with the income of a subsidiary for Indiana adjusted gross income tax purposes, even though the parent and subsidiary were engaged in a unitary business.

The Sony Amendment, while clearly beneficial to foreign multinational companies operating in Indiana through subsidiaries, had a discriminatory impact on domestic multinational companies because it did nothing to clarify Indiana's taxation of foreign source dividends received by domestic multinationals from their foreign operations. For example, a German multinational company operating through a subsidiary in Indiana would, under the Sony Amendment, clearly have no liability to pay Indiana tax on its income earned in Germany, no matter how integrated the two corporations were. A U.S. multinational, however, operating in Indiana with a subsidiary in Germany has been under a cloud as to whether it could be held liable for Indiana adjusted gross income tax on its dividend income from the German subsidiary.

Recognizing the need to eliminate any ambiguity as to this inequity, the 1987 legislature enacted Indiana Code section 6-3-2-12 which expressly provides a deduction from adjusted gross income of foreign source dividends.[101] Note that this is a deduction provision rather than an exemption provision, requiring the taxpayer to include and then deduct foreign source dividends *from* adjusted gross income to arrive at *Indiana* adjusted gross income. Under section 6-3-2-12, "'foreign source dividend' means a dividend from a foreign corporation" and "includes any amount that a taxpayer is required to include in its gross income for a taxable year under section 951 of the Internal Revenue Code,"[102] which is commonly known as Subpart F income. However, the section expressly provides that the term "foreign source dividend" does not include the foreign tax gross-up.[103] Under section 78 of the Internal Revenue Code, certain taxes which are deemed to be paid by a corporation are treated as dividend income received by the corporation. This income is commonly referred to as the foreign tax gross-up. The legislature has separately provided that the foreign tax gross-up should be subtracted from a taxpayer's section 63 taxable income *to arrive at* adjusted gross income,[104]

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[101] IND. CODE § 6-3-2-12(b) (Supp. 1987) (effective Jan. 1, 1988).
[102] *Id.* § 6-3-2-12(a).
[103] *Id.*
[104] IND. CODE § 6-3-1-3.5(b)(4) (Supp. 1987) (effective Jan. 1, 1988).

the foreign tax gross-up is not considered foreign source dividend.

The amount of the foreign source dividend deduction to which the taxpayer is entitled depends upon the taxpayer's percent of ownership of the dividend payor. The deduction is equal to 100% of the foreign source dividend if the taxpayer owns at least 80% "of the total combined voting power of all classes of stock of the foreign corporation from which the dividend is derived."[105] The deduction is equal to 85% of the foreign source dividends if the taxpayer owns at least 50% but less than 80% of the total combined voting power of all classes of stock of a foreign dividend payor.[106] The deduction is reduced to 50% of the foreign source dividends if the taxpayer owns less than 50% of the total combined voting power of all classes of stock of the dividend payor.[107]

With the 1987 enactment of Indiana Code section 6-3-2-12, it is hoped that the potential for discriminatory taxation of U.S. multinationals will be laid to rest. U.S. multinationals are certainly entitled to compete both domestically and in the worldwide marketplace on an equal footing with their foreign multinational competitors. The constitutional mandates of the federal due process and equal protection clauses,[108] as well as the unreasonable classification prohibition of the Indiana Constitution,[109] may indeed dictate equal tax treatment for the foreign source income of both foreign and domestic multinational companies. On this question, the form of the income (i.e., whether the foreign source income is taxed on a combination basis or is taxed in the form of divided income) should be included since the substance of the taxation is still to tax the U.S. multinational's foreign earnings. As noted, section 6-3-2-12 should serve to eliminate any further ambiguity as to the equal tax treatment of foreign and domestic multinational companies.

V. The Great Lakes Interstate Sales Compact

On July 21, 1986, Indiana, joining five other midwestern states, signed the Great Lakes Interstate Sales Compact. Indiana, Illinois, Michigan, Minnesota, Ohio and Wisconsin entered into this Compact for the expressed primary purpose to ferret out those out-of-state vendors who sold to customers in the six states but who had never collected or remitted sales tax to the customer's state.[110] The targets were principally

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[105] Ind. Code § 6-3-2-12(c) (Supp. 1987) (effective Jan. 1, 1988).

[106] *Id.* § 6-3-2-12(d).

[107] *Id.* § 6-3-2-12(e).

[108] U.S. Const. amend. XIV, § 1.

[109] Ind. Const. art. I, § 23.

[110] Great Lakes Interstate Sales Compact, July 21, 1986. Wisconsin withdrew from the Compact by an executive order signed by Governor Anthony S. Earl on August 31, 1987. South Dakota signed the Compact on December 11, 1987, and North Dakota, Iowa and Nebraska are considering signing the Compact.

to be the border retailers who sold appliances, furniture and other big ticket items to nearby customers in adjacent states, *without charging the customer's state's sales tax.* As Indiana Revenue Commissioner M. F. Renner stated in a letter to Indiana retailers, "these are the sales which represent unfair competition to you, our in-state merchants, who find out-of-state business undercutting your prices because they are not required to collect the sales tax, as you do."[111]

Given this laudable objective, the Great Lakes Compact hardly seemed like an issue that most state taxpayers should be concerned about, especially those taxpayers who were not engaged in retailing. But the Compact does indeed have the potential for becoming a controversial multistate audit program that may impact taxpayers far beyond those selling goods across state lines. It appears now that the Compact may be invoked by the member states, not only to encourage out-of-state vendors to collect and remit sales tax, but as a vehicle for obtaining and sharing a broad range of information about all taxpayers—not just information relating to sales tax and not just about taxpayers engaged in retailing. It appears that *anyone*—retailer, wholesaler, manufacturer, or service provider—who does business in any of the Compact states may be affected by seemingly innocuous but actually far-ranging reciprocal audit arrangements.

A. What the Compact Says

Each of the states was authorized to enter into this Compact by enabling legislation passed by its respective legislature or by an executive order. In Indiana's case, Indiana Code section 6-8.1-3-7 permits the Indiana Department of Revenue to enter into reciprocal agreements with the taxing officials of other state governments "*to furnish and receive information relevant to the administration and enforcement of [Indiana's] taxes.*"[112] Thus, the threshold question as to the propriety of Indiana's

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[111]Letter from M. F. Renner to Indiana Retail Merchants (Jan. 19, 1987) [hereinafter Renner Letter].

[112]Ind. Code § 6-8.1-3-7 (1982) (emphasis added). This statute restricts the Revenue Department's power with regard to reciprocal agreements to the administration and enforcement of listed taxes. According to Ind. Code § 6-8.1-1-1 (Supp. 1987):

> "Listed taxes" or "taxes" includes only the gross income tax (IC 6-2.1); the state gross retail and use taxes (IC 6-2.5); the adjusted gross income tax (IC 6-3); the supplemental net income tax (IC 6-3-8); the county adjusted gross income tax (IC 6-3.5-1-1); the county option income tax (IC 6-3.5-6); the auto rental excise tax (IC 6-6-9); the bank tax (IC 6-5-11); the production credit association tax (IC 6-5-12); the intangibles tax (IC 6-5.1); the gasoline tax (IC 6-6-1.1); the special fuel tax (IC 6-6-2.1); the motor carrier fuel tax (IC 6-6-4.1); the hazardous waste land disposal tax (IC 6-6-6.6); the cigarette tax (IC

participation in the Compact is whether, under the agreement, the Revenue Department will be committed to furnish and indeed will furnish to the other member states information which, while possibly *relevant* to the enforcement and administration of the *other* state's taxes, would have no relevance to the enforcement and administration of Indiana taxes. Consequently, the scope of the Compact must be carefully examined in the light of the underlying statutory authority. As emphasized by the underscored quoted language, the Indiana reciprocity provision literally limits the Revenue Department to the furnishing and receiving of information *relevant* to the administration and enforcement of *Indiana* taxes.

The purpose of the Compact is set forth at its beginning. The Compact states:

> This Compact is designed to increase compliance with each states' sales and use tax law, primarily as that law applies to sale transactions made across the state boundaries. The constitutional constraints placed on a state's power to tax transactions in interstate commerce have caused all states . . . that levy a retail sales tax to impose a complementary use tax, to assure that all transactions are equally subject to tax and to protect instate vendors from unfair competition from vendors located in other states. However, in practice, goods purchased from an outstate vendor and shipped to a consumer instate frequently escape use taxation unless the outstate vendor is registered to collect and remit the use tax to the consumer's state. This tax avoidance is particularly likely to occur when the consumer is an individual and probably will not be audited for sales or use tax purposes. By this Compact, the tax collection agencies of the Great Lakes States will increase compliance with the sales and use tax laws of their states . . . .[113]

The body of the Compact can be divided into three parts. The first part could be called the "registration phase." The signatory states agree that they will "vigorously encourage" vendors in their home states to register with other signatory states to collect and remit use tax on sales into those other states.[114] In this regard, all Great Lakes Compact signatory states engaged in a letter writing and publicity campaign in

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6-7-1); the beer excise tax (IC 7.1-4-2); the liquor excise tax (IC 7.1-4-3); the wine excise tax (IC 7.1-4-4); the malt excise tax (IC 7.1-4-5); the petroleum severance tax (IC 6-8-1); the various innkeeper's taxes (IC 6-9); the county food and beverage tax (IC 6-9-13); and the oil inspection fee (IC 16-6-11).

[113]Great Lakes Interstate Sales Compact, July 21, 1986.

[114]*Id.* at 2.

early 1987 encouraging their in-state vendors to register in the other Compact states. There was also a carrot offered to encourage such registration. The states provided that if a vendor voluntarily registered in another Compact state before March 31, 1987, the vendor's state of residence would not exchange any information with that state on the vendor's past transactions.[115] The member states also advised their resident vendors that "the chances of being audited for failing in the past to collect use tax, and of being required to pay it, are also reduced if you voluntarily register by March 31, 1987."[116]

The second part of the Compact involves conducting audits. The signatory states agree to "vigorously pursue by audit *the discovery* of untaxed sales made by instate vendors to individual or business consumers in the other Great Lakes States."[117] The Compact contemplates two types of audits. First, there are audits conducted by the Compact state on its own.[118] This would be where Indiana audits an Indiana-based taxpayer and discovers that this taxpayer is making interstate sales to Michigan customers. Secondly, there are duties conducted by a Compact state at the specific request of another state.[119] This would be, for example, where Indiana audits an Indiana-based taxpayer at the request of Michigan because Michigan suspects that the taxpayer is making untaxed sales to Michigan consumers.

These audits will then lead directly into the third phase of the Compact, the exchange of information. The Compact provides that information gathered in these audits regarding interstate sales shall be transmitted to the other state or states.[120] How the information will be used is not specified in the Compact, although the implication is that it will be used to encourage voluntary registration of the out-of-state vendor and/or compel the payment of use tax by in-state residents who purchased from the vendor.[121]

The Compact itself has at least two other provisions that are worth noting. First, it specifically provides that the signatory states "will not attempt to subject any vendor to franchise, income, property, or other taxes of their states *solely* because that vendor has registered to collect use tax in response to requests made under this Compact" and that "registration to collect tax, in and of itself, will not require the vendor

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[115]Renner Letter, *supra* note 111, at 1.

[116]*Id.*

[117]Great Lakes Interstate Sales Compact, July 21, 1986, at 2 (emphasis added).

[118]Great Lakes Interstate Sales Compact, July 21, 1986, at 2.

[119]*Id.*

[120]*Id.*

[121]*Id.* at 1.

to register to do business in that state."[122] Second, the Compact recognizes that:

> Although this Compact addresses cooperation between the Parties in the administration of sales and use taxes, any of the Parties may enter into Addenda creating cooperative administrative efforts for other taxes, including corporate franchise or incomes tax [sic] and excise taxes, such as motor vehicle fuel and cigarette taxes.[123]

Thus, on its face, it certainly appears that the Compact may require the Indiana Revenue Department to furnish to the other member states various kinds of tax information and data obtained from Indiana taxpayers that is *not relevant* to the administration and enforcement of *Indiana* taxes.

B. *How the Compact has been Administered*

On the voluntary registration phase, the states have been very active and apparently persuasive, having had surprising success. Indiana reports that, in the first 12 months following the signing of the Compact, it has had over 4,000 requests for registration materials from vendors in other Compact states, with over 2,400 of such requests coming from Illinois vendors. Indiana has had almost 2,000 vendors actually register with it, almost 1,200 of those being Illinois vendors.[124] Taxpayers considering registration in another Compact state, however, should be aware that their voluntary registration may result in being approached about audits for other taxes by that state. The simple fact is that once a retailer registers in another state, its name and business are then known to that state's revenue department and it is more likely that *that* state will audit the retailer. Consequently, while the Compact provides that the member states will not attempt to impose any other tax *solely* because a taxpayer has registered to collect sales tax for that state,[125] it does *not* say that if the state finds some other nexus between the registrant and the state it will not impose other taxes. Thus, a taxpayer who voluntarily registers in another state to collect sales tax will likely incur an increased exposure to an audit for *all* the state's taxes, and an increased potential for liability—past, present and future—for *all* of the state's taxes.

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[122] *Id.* at 4 (emphasis added).

[123] Great Lakes Interstate Sales Compact, July 21, 1986, at 3.

[124] Interview with James Mundt, Deputy Commissioner, Indiana Department of Revenue (June 11, 1987).

[125] Great Lakes Interstate Sales Compact, July 21, 1986, at 4.

The Great Lakes audit program and the exchange of information are underway. It is understood that Indiana, for example, has instructed all of its auditors to routinely examine a taxpayer's books and records for interstate sales to other Compact states as part of the regular audit procedure. Lists of such sales are compiled and handed over to the other Compact states. As a practical matter, the taxpayer may or may not be advised that this is happening. Generally, the states will leave it up to the auditor whether to tell the taxpayer that he is gathering this information to hand over to another state. States are also requesting other Compact states to perform audits on their behalf. Indiana has received only a few such requests during the survey period.[126]

On the enforcement side, the Compact states are proceeding to issue proposed assessments against vendors which are discovered to be making interstate sales and which have nexus under the traditional standards in the assessing state. This is an important point about the Compact. It does not change a signatory state's nexus standards for sales tax collection responsibility. If the member state has adopted one of the new nexus laws, then this standard will control. However, if the state is still using a limited definition of when a retailer is engaged in business in the state so as to trigger sales tax collection responsibility, the more limited standard will control.

If no nexus between the vendor and the state is found, the state will likely issue assessments of use tax against the vendor's customers. Some states have found the assessment of use tax on the customer an effective "club" to compel an out-of-state vendor to register and collect tax. New York, for example, has made no secret of its intent to assess the in-state customers of certain out-of-state retailers until those retailers register or their customers quit buying from them.[127]

In addition to the foregoing, which relates only to sales and use tax, in June, 1987, the Compact states *also* began auditing all taxpayers who apportion their net income to determine whether they have activities in any of the other Compact states for income and franchise tax purposes and sharing that information with the other Compact states. The Compact states have adopted what is called the "Great Lake States' Questionnaire." This Questionnaire asks the taxpayer first to state whether, for the current year and the three preceding years, it filed a sales and use tax return *and* an income or franchise tax return in each of the Great Lakes states. Unless a taxpayer answers that it did file in all of the

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[126]Interview with James Mundt, Deputy Commissioner, Indiana Department of Revenue (June 11, 1987).

[127]Pamphlet, *New York/New Jersey Cooperative Interstate Tax Enforcement*, Feb. 1986.

Compact states for all four years, the taxpayer is asked to fill out the "activities" section of the questionnaire which lists 22 activities and asks the taxpayer whether it performed any one of these in any of the Compact states.[128] The activities listed include:

> 1. Maintained a business location of any kind (*e.g.*, an office, repair or parts shop, warehouse, place of distribution, or sample, display or sales room). . .
> 6. Owned a stock of goods in hands of a distributor or other nonemployee representative. . .
> 8. Leasing of tangible property or licensing of intangible rights for use in the state. . .
> 10. Performed construction contracts or personal service contracts. . .
> 13. Collected delinquent accounts or deposits on new accounts. . .
> 14. Conducted credit investigations.[129]

These questionnaires are then provided to any of the other states in the Compact with respect to which the taxpayer provides an affirmative answer.

C. *Questions About the Great Lakes Compact*

Can Indiana—indeed can the Compact member states as a regional body—legitimately, collectively carry out the dictates of the Compact? Proponents of the Compact point to the U.S. Supreme Court decision in 1978 in *U.S. Steel Corporation v. Multistate Tax Commission*.[130] In *U.S. Steel*, the Supreme Court declared the Multistate Tax Compact to be constitutional despite the argument that it violated the United States Constitution which prohibits a state from entering into any agreement with another state without the consent of Congress.[131] The Court rejected a literal reading of this constitutional prohibition and reaffirmed the position that such interstate agreements are only prohibited when they tend to increase the political power of the states so that it encroaches upon or interferes with the just supremacy of the United States.[132] While U.S. Steel argued that the enforcement powers conferred upon the Multistate Tax Commission permitted that body to exercise authority over interstate business to a greater extent than the sum of the states'

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[128]Great Lakes States' Questionnaire at 1.
[129]Great Lakes States' Questionnaire at 2.
[130]434 U.S. 452 (1978).
[131]U.S. Const. art. I, § 10, cl. 3.
[132]434 U.S. at 471.

authority acting individually, the Court found that this was "nothing more than reciprocal legislation for providing mutual assistance to the auditors of the member States" and that such reciprocal legislation should be upheld.[133]

However, what the proponents of the Great Lakes Interstate Sales Compact miss is that the issue of whether, regardless of its facial constitutionality, a reciprocal agreement which seeks to expand a state's investigatory power beyond *either constitutional or statutory authority* is still lawful was not presented in *U.S. Steel.* Suppose a taxpayer runs a retail business from its headquarters in Seattle, Washington. It has a retail outlet in Indiana. It has no activity whatsoever in Illinois, but it does make interstate sales to Illinois customers from its Seattle office. Indiana audits this taxpayer. In performing that audit, Indiana learns about the taxpayer's sales from Washington into Illinois. Does it not violate due process and state jurisdictional tenets for Indiana to obtain this information and then hand it over to Illinois—when in fact Illinois would have had no nexus under traditional jurisdictional standards over the taxpayer? Implemented in this way, the Compact could become a network of jurisdictional transmission lines that would eviscerate traditional state jurisdictional standards. In any event, it is wrong to think that the *U.S. Steel* decision provides the answer to the issue—because this issue was never addressed in that case.

The Compact should also be viewed in light of each state's law. It is well settled that each state's department of revenue is a part of the executive branch of that state. As a general tenet, revenue departments can only exercise those powers granted to them by their state legislatures. It should therefore be axiomatic that the state revenue departments cannot use multistate compacts to expand their powers beyond those provided by their respective legislatures. But it appears that, at least in the case of the Indiana Revenue Department, the Great Lakes Compact in some instances goes well beyond the restraints of the Indiana statutory law on the audit and investigatory scope of the Indiana State Department of Revenue. For example, the statutory authority of the Indiana Audit Division to inspect any books, records or property of any taxpayer is limited to inspection of only such documents as are "*relevant to the determination of the taxpayer's tax liabilities.*"[134] If, in the above example of the Seattle, Washington business, information regarding the taxpayer's sales from Washington to Illinois customers is not relevant to the determination of the Indiana tax liabilities of that taxpayer, can Indiana, in compliance with its Compact obligations, seek to obtain such infor-

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[133]*Id.* at 475-76.

[134]Ind. Code § 6-8.1-4-2(3) (1982) (emphasis added).

mation that seems beyond the scope of the inspection authority?

Buttressing the conclusion that the authority of the Indiana Revenue Department to audit an Indiana taxpayer and to inspect the books and records of an Indiana taxpayer is statutorily circumscribed is the fact that, under Indiana Code section 6-8.1-5-4, an Indiana taxpayer, for Indiana sales and use tax and income tax purposes, is *only* required to keep, retain and make available for inspection those books and records that are necessary to enable the Indiana Revenue Department to determine the taxpayer's liability for those *Indiana* taxes.[135]

It is submitted that an examination of the statutory audit authority of the revenue departments of the other member states in the Compact might well raise the same serious doubt as to whether those revenue departments do indeed have the statutory authority to carry out the reciprocal audit amendments of the Compact.

Finally, a broad policy question must be asked. Did the Indiana General Assembly really intend that Indiana start auditing for Michigan, Wisconsin, Illinois, etc., sales tax and now apparently income tax purposes when it provided that Indiana could enter into reciprocal agreements to furnish and receive information for purposes of administering and enforcing *Indiana's* taxes? Remember, also, that the Indiana General Assembly specifically pulled Indiana out of the Multistate Tax Compact in 1977. Is this new Great Lakes Questionnaire in spirit contrary to the legislature's intent that Indiana not be part of the type of joint auditing program used by members of the Multistate Tax Compact?

Taxpayers have been surprisingly quiet about the Great Lakes Compact, as well as the many other compacts that have sprung up around the country. New York now has such agreements with several states, including Arizona, California, Florida and Connecticut.[136] Ohio, in addition to the Great Lakes Compact, has compacts with Pennsylvania, West Virginia and is currently negotiating with Kentucky.[137] Perhaps, up to now, most taxpayers have had very little reason to be concerned about these compacts because they were not affected by the compacts. But if the Great Lakes states are intent upon using this new Questionnaire with every taxpayer that apportions its net income, there are many taxpayers who will *now* be affected by the Great Lakes Compact.

In conclusion, in only a short time, the Compact seems to have grown from a device to encourage vendors to collect and remit sales tax to a vehicle for expanding the jurisdictional power of the states to obtain information for net income tax purposes. And, therefore, we

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[135]Ind. Code § 6-8.1-5-4(a)-(c) (Supp. 1987).

[136]Telephone interview with the New York Department of Revenue (Sept. 1987).

[137]Telephone interview with the Ohio Department of Revenue (Sept. 1987).

suspect that taxpayers will start questioning and even challenging this Compact in either the courts or the state legislatures.[138]

[138]As noted in footnote 110 above, Wisconsin withdrew from the Compact on August 31, 1987. Wisconsin is the home state for a large number of mail order houses involved in the *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), fight on the national level, and Wisconsin's participation in the Great Lakes Compact become the subject of an organized lobbying effort to withdraw Wisconsin from the Compact. Opponents of Wisconsin's participation in the Compact argued that the Compact was just a subterfuge to get around the constitutional prohibitions set forth in *National Bellas Hess* against compelling mail order sellers to collect sales tax. They also argued that under the Compact, Wisconsin and the other Compact states would be obtaining and sharing trade secrets regarding their businesses (presumably customer lists, etc.). Whether Wisconsin is an aberration because of the influence of the mail order houses in that state or portends that other states will re-evaluate their participation in the various compacts, remains unanswered.

Nonparty Tortfeasors in Indiana: The Early Cases

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I. INTRODUCTION

The fairness of any system of comparative fault, as the beauty of a rose, is in the eye of the beholder. There is no objective standard by which to judge the fairness of a given system of comparative fault. The standard necessarily is subjective, because it includes a balancing of several objectives. In order to conclude whether a given system is substantially fair or, on the other hand, unreasonably harsh, one must first define and assign a priority to the goals to be accomplished in the implementation of a comparative fault scheme.

There are two competing primary objectives of comparative fault. One is the adherence to the cornerstone principal of comparative fault. That is, each person contributing to cause an injury must bear the burden of reparation in exact proportion to his share of the total fault. The other primary objective is the maximum of full compensation to the injured plaintiff.[1] To give priority to one goal is to diminish the other.

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[1]Other objectives, of nearly equal importance, are simplicity of application, or "workability," encouragement of settlements and predictability of results at trial. The Indiana system of comparative fault seems to have survived the early reported decisions without reported criticism with respect to each lesser objective. The importance of the early cases construing the Indiana Act was recognized by one eminent commentator: "The litigation which will unfold in the near future over the Act will be the best indicator of its workability, and of the changes that can be made to improve the Act." Woods, *Comparative Fault and Product Liability in Indiana*, 17 IND. L. REV. 999, 1028 (1984).

The opinions which have been reported have not presented particularly difficult issues. The interpretations of the Act have been simple and straightforward, with the single exception in Hill v. Metropolitan Trucking, Inc., 659 F. Supp. 430 (N.D. Ind. 1987). This apparent lapse in careful analysis, however, seems to be *dictum*. *See infra* text accompanying note 21. The courts have resisted the inclination to twist the meaning or application of the Act in order to achieve an illogical or unintended result. Notions of harsh or unfair results, however, were bothersome to at least one court:

> The Court cannot deny that Indiana's Comparative Fault Act gives rise to numerous uncertainties and is potentially harsh in certain instances. As post-Act litigation develops, some of these uncertainties will be resolved, and the *legislature* may be called upon to modify some of the Act's potential harshness.

Huber v. Henley, 656 F. Supp. 508, 512 (S.D. Ind. 1987) (emphasis added). It is apparent that the harshness which the *Huber* court had in mind was the prospective apportionment at trial of some percentage of fault attributed to a nonparty tortfeasor against whom no recovery could be had by plaintiff because of the expiration of the time within which such claim could be perfected. *See infra* text accompanying note 29.

The evidence of such competition between the primary objectives is implicit in the placement of the financial burden attributable to certain nonparty tortfeasors.[2]

Perhaps the most vivid and commonly encountered example of the relationship between the competing objectives lies in the method employed by a given system to deal with the burden created by the insolvent tortfeasor. If preeminence is given to the objective of insuring full compensation to the injured plaintiff, the burden of the insolvent tortfeasor's share of liability must be borne by the remaining defendants, likely through the doctrine of joint and several liability. Such was the incidence of the burden of insolvency under the traditional tort system, which included the doctrine of joint and several liability. The plaintiff made no sacrifice of recovery by omitting insolvent tortfeasors from the

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[2]The Indiana Comparative Fault Act, IND. CODE §§ 34-4-33-1 to -14 (Supp. 1987), places this burden largely on the plaintiff, thereby assigning a priority to the principle of loss distribution according to fault at the sacrifice of full satisfaction of plaintiff's damages:

> First, the provisions of Indiana's Comparative Fault Act signal a legislative policy favoring the principle of fair allocation among all tortfeasors. In most instances, the legislature gave this principle preeminence over the objective of fully compensating plaintiffs. In return for the removal of the contributory negligence bar to recovery, plaintiffs lost the ability to recover the full measure of damages from any one joint tortfeasor. With this abolition of joint and several liability, the legislature favored strict apportionment of fault and left the burden of damages attributable to insolvent tortfeasors, inadvertently omitted tortfeasors, intentionally omitted tortfeasors, and jurisdictionally unavailable tortfeasors on plaintiffs. Any interpretation of legislative intent must therefore be made with a cognizance of this policy . . . .

Id. at 511. Such placement is the result of the consideration of the fault of nonparty tortfeasors in the apportionment scheme, coupled with the abolition of the doctrine of joint and several liability. *Id.* at 510.

The comparative negligence common law of Kansas likely influenced the drafters of the Indiana Act. H. WOODS, COMPARATIVE FAULT 585 app. (2d. ed. 1987). The Supreme Court of Kansas, in a benchmark comparative fault case, accepted the "harsh result" as a part of its system:

> The ill fortune of being injured by an immune or judgment-proof person now falls upon plaintiffs rather than upon the other defendants, as was the practice in this state prior to the enactment of [the comparative negligence statute]. The risk of such ill fortune is the price plaintiffs must pay for being relieved of the burden formerly placed on them by the complete bar to recovery based upon contributory negligence.

Miles v. West, 224 Kan. 284, 580 P.2d 876 (1978). The provision of the plan allowing nonparties to be included in the apportionment scheme was judicially adopted in Kansas, although the Kansas statute, since 1976, has provided that "on motion of *any* party, . . . any other person whose causal negligence is claimed to have contributed to such death, personal injury or property damage shall be joined as an additional party to the action." KAN. STAT. ANN. § 60-258a(c) (1976) (emphasis added); Brown v. Keill, 224 Kan. 195, 580 P.2d 867 (1978).

suit, or by levying his judgment on the solvent judgment debtors.[3] While such tactics tended to maximize full recovery to plaintiff, the burden of reparation was distributed without regard to relative fault.[4]

In contrast, in a system of comparative fault which gives preeminence to the objective of contribution in proportion to fault, the doctrine of joint and several liability is abolished. Therefore, the plaintiff bears the burden of the insolvent defendant. Indiana has adopted such a system. One must bear in mind, however, that in the comparative fault model, the plaintiff may also be a tortfeasor. In judging the fairness of comparative fault in Indiana, there is no inherent reason to favor such a plaintiff.[5]

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[3]Similarly, plaintiff was permitted under the former practice to enter into loan receipt agreements (a variation of the so-called "Mary Carter" agreements) with certain cooperative tortfeasors, both before and during suit, thus hastening his partial recovery of damages and bringing extraordinary leverage to bear on other recalcitrant tortfeasors. Eilbacher, *Comparative Fault and the Nonparty Tortfeasor*, 17 IND. L. REV. 903, 910 (1984).

The use of such agreements can be insidious under comparative fault as it was under the former practice. *See* Note, *Mary Carter in Arkansas: Settlements, Secret Agreements and Some Serious Problems*, 36 ARK. L. REV. 576 (1983). The use of loan receipt agreements is favored under Indiana law, provided the existence of the agreement is disclosed to the other parties and is not so collusive as to undermine the adversarial nature of the trial where the lender remains a party. N. Ind. Pub. Serv. Co. v. Otis, 145 Ind. App. 159, 250 N.E.2d 378 (1970). *See* Annotation, *Validity and Effect of Agreement with One Cotortfeasor Setting His Maximum Liability and Providing for Reduction or Extinguishment Thereof Relative to Recovery Against Nonagreeing Cotortfeasor*, 65 A.L.R.3D 602 (1975).

[4]Allocation of financial burden according to fault is not necessarily inconsistent with the doctrine of joint and several liability.

> Taking the view that the effect of a rule of joint and several liability is unfair and inconsistent with the principle of liability in proportion to fault, several jurisdictions, Indiana now included, have abolished or restricted joint and several liability. Most states, however, retain the doctrine and alleviate the perceived unfairness by providing for contribution among joint tortfeasors—either on a pro rata basis or on the basis of relative fault of the parties. The Uniform Act provides for joint and several liability and gives defendants a right of contribution in proportion to a degrees of fault.

Smith & Wade, *Fairness: A Comparative Analysis of the Indiana and Uniform Comparative Fault Acts*, 17 IND. L. REV. 969, 973-74 (1984). The authors strongly argue the merits of "proportional allocation of the fault of absent tortfeasors and insolvent parties among all parties to the action." *Id.* at 997. However, the legislature clearly rejected this concept in the drafting of the Indiana Act. *See* IND. CODE § 34-4-33-5 (Supp. 1987).

[5]The Indiana Act does not use the term "tortfeasor" to describe either plaintiffs, defendants, or nonparties, each of whom may be guilty of fault in a given case. It is intellectually dangerous to associate wrongdoing only with the defendant and nonparties.

> Under such a system [of comparative negligence] it no longer appears proper to label the defendant as a "tortfeasor," with the stigma and various undesirable connotations attached to the word, when in fact the plaintiff may be the more

Moreover, under Indiana's modified system of comparative fault, not only may a successful plaintiff be a tortfeasor, his share of the causal fault may be *greater* than that of a defendant from whom the plaintiff recovers.[6]

For example, assume the percentage of fault of the plaintiff to be 40%, and the percentage of fault of each of three defendants to be 20%. The plaintiff is entitled, under Indiana law, to recover 20% of his total damages from each defendant. While it seems eminently unfair to permit a plaintiff tortfeasor to recover from a defendant tortfeasor who is only half as much at fault as the plaintiff, such result is precisely consistent with the principle that each tortfeasor must bear the financial burden of an injury in exact proportion to his share of the total fault. Indeed, the plaintiff has borne 40% of the burden of his own injury. Although such an allocation of the burden is contrary to the traditional tort system's maxim that any contributory negligence on the part of the plaintiff was a complete bar to his recovery,[7] the allocation is not unfair to any one participant.

> culpable party in terms of contributory fault.

Goldenberg & Nicholas, *Comparative Liability Among Joint Tortfeasors: The Aftermath of Li v. Yellow Cab Co.*, 8 U. West L.A. L. Rev. 23, 29 (1976).

[6]Indiana has what is commonly known as a "51%" system. *See generally* Wilkins, *The Comparative Fault Act at First (Lingering) Glance*, 17 Ind. L. Rev. 687 (1984). One commentator lists Indiana among the majority of states which have adopted a New Hampshire plan, which signifies a state where a plaintiff may recover so long as the percentage of fault attributable to him is not greater than that of *all* defendants. H. Woods, *supra* note 2, at 28-29.

> In an action based on fault . . . the claimant is barred from recovery if his contributory fault is greater than the fault of all persons whose fault proximately contributed to the claimant's damages. Ind. Code § 34-4-33-4(a) (Supp. 1987).

In a few states which have adopted "51%" systems, such as Wisconsin, the contributory fault of the plaintiff is compared to the fault of *each* defendant, and recovery is permitted only if the plaintiff's fault is not greater than the fault of the person against whom recovery is sought. *See* Wis. Stat. Ann. § 895.045 (West 1985). For a discussion of the practical significance of such a provision, see C.R. Heft & C.J. Heft, Comparative Negligence Manual § 1.40 (1978 Rev.) [hereinafter Heft & Heft].

The comparison of the plaintiff's fault with the aggregate fault of *all* tortfeasors, including nonparties, caused one commentator to describe the Indiana plan as "among those most favorable to claimants in the aspect of when recovery is allowable." Bayliff, *Drafting and Legislative History of the Comparative Fault Act*, 17 Ind. L. Rev. 863, 866 (1984).

[7]It may be supposed at first glance that the provision of the Indiana Act which bars plaintiff's recovery if his share of the assigned fault is greater than 50% was a gesture toward the traditional tort sense of accountability. Such motivation is denied by one commentator who was a key participant in drafting the proposed act and shepherding it through the legislature. Bayliff reports that the "greater than" bar was, in fact, a response to the concern of the insurance lobby with the prospect of plaintiffs and defendants

By abolishing the doctrine of joint and several liability and including a provision for allocation of fault to nonparty tortfeasors,[8] the Indiana legislature has unequivocally assigned the highest priority to the objective of allocating reparation according to fault.[9] In the early cases, the courts have recognized such priority, and have demonstrated unwavering fealty to that objective.[10]

The Indiana Act permits the fault of all liable parties to be considered in the apportionment scheme, whether or not they are parties to the suit.[11] Consequently, all but one of the early cases have in some fashion dealt with the treatment of the conduct of the nonparty claimed to have been guilty of some causal fault for the plaintiff's injury.[12] These cases have adhered to the principle that each person contributing to cause an injury must bear the burden of reparation, therefore, in exact proportion

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both being able to recover from each other in the same action. *Id.* at 863.

Such an explanation prompts the question of why the threshold for a complete bar to recovery was not set at 50% of the total fault. The existing provision still permits a recovery by both plaintiff and defendant, against each other, when the fault of each is exactly 50%. This single possibility for reciprocal recovery would have been eliminated had the statutory language barred the plaintiff from recovery if his contributory fault were *equal to or greater than* the fault of the other tortfeasors.

[8]Ind. Code § 34-4-33-5 (Supp. 1987).

[9]*See supra* text accompanying note 2. The Indiana Act deviates from such priority as evidenced by its treatment of the immune tortfeasor and those whose liability is limited by the exclusive remedy provision of the Workmen's Compensation Act. *See* Discussion of immune tortfeasors, Section II *infra*. The Act also deviates somewhat in its requirement that a legal nonparty to whom fault is allocated must be identified by name. Ind. Code § 34-4-33-6 (Supp. 1987). *See generally* Eilbacher, *supra* note 3, at 920.

[10]*See infra* notes and accompanying text.

[11]The Indiana Act requires that the jury be instructed *seriatim* as to the apportionment of fault and the calculation of the verdict against each defendant and liable nonparty. Ind. Code § 34-4-33-5 (Supp. 1987). Indiana is the first state to provide by statute for the inclusion of fault of nonparties in the apportionment of fault by the trier of fact. *See generally* Heft & Heft, *supra* note 6, ch. 3.

[12]As of this writing five reported decisions have construed the act, which became applicable to civil action accruing on or after January 1, 1985. Act of March 5, 1984, Pub. L. No. 174-1984, § 9, 1984 Ind. Acts 1468, 1473. They are, in chronological order, Walters v. Dean, 497 N.E.2d 247 (Ind. Ct. App. 1986); State v. Schuetter, 503 N.E.2d 418 (Ind. Ct. App. 1987); Huber v. Henley, 656 F. Supp. 508 (S.D. Ind. 1987); Hill v. Metropolitan Trucking, Inc., 659 F. Supp. 430 (N.D. Ind. 1987), and Persinger v. Lucas, 512 N.E.2d 865 (Ind. Ct. App. 1987). Of these, only the *Persinger* case did not involve the construction of the nonparty provision of the Act. It dealt with the mitigation of damages defense. *See supra* text accompanying note 39. At the time this Article was going to print, two additional decisions construing the Indiana Comparative Fault Act were reported: Huber v. Henley, 669 F. Supp. 1474 (S.D. Ind. 1987) (Huber II); and Farmers & Merchants State Bank v. Nolfolk & W. Ry. Co., 673 F. Supp. 946 (N.D. Ind. 1987). Because these cases are outside the survey period, they have not been incorporated in the discussion; however, the cases have been footnoted where relevant.

to his share of the total fault. The courts have applied the letter of the Act, ever mindful that the principle of proportional liability reflects the intent of the legislature, and have left the cure for any injustices to the Indiana General Assembly.

II. The Immune Tortfeasors

If one accepts the proposition that the goal of fairness is best served by adherence to the principle requiring contribution according to fault, then one of the more disquieting results under the Indiana system occurs in cases involving tortfeasors who have been statutorily exempted in the drafting of the act and by common law, i.e., the immune tortfeasor and the employer. The burden of fault of the insolvent tortfeasor has been placed squarely on the plaintiff through the abolition of joint and several liability coupled with the statutory retention of the prohibition of contribution among tortfeasors.[13] With respect to immune tortfeasors, the act has perpetuated the shifting of the burden of their fault to other participants in the casualty by its requirement that a nonparty, for purposes of allocation of fault, must be "a person who is, or may be, liable" to the plaintiff.[14] Because an immune tortfeasor cannot be liable to the plaintiff, the fault of such tortfeasor may not be considered by the trier of fact. Therefore, no damages may be assessed against such participant in the casualty.

There are three commonly encountered classes of tortfeasors who are immune or who are insulated from tort liability under Indiana's act:

1. Parents for claims by an unemancipated child;[15]

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[13]In Indiana, there has never been a right of contribution or indemnity in favor of a negligent tortfeasor. McClish v. Niagara Machine & Tool Works, 266 F. Supp. 987 (S.D. Ind. 1967). This common law prohibition was incorporated into the Act as follows:

> In an action under this chapter, there is no right of contribution among joint tortfeasors. However, this section does not affect any rights of indemnity.

Ind. Code § 34-4-33-7 (Supp. 1987). The statute preserves the right of indemnity of one who is constructively liable only, for the wrongful conduct of another. Coca-Cola Bottling Co. v. Vendo Co., 455 N.E.2d 370 (Ind. Ct. App. 1983).

[14]Ind. Code § 34-4-33-2(a) (1984).

[15]It is firmly established in the Indiana common law that a parent is immune in tort actions brought by his or her child, but the immunity appears to be limited to torts committed before emancipation of the child. Vaughn v. Vaughn, 161 Ind. App. 497, 316 N.E.2d 455 (1974).

An earlier Indiana case reviewed the reason for the immunity:

> From our knowledge of the social life of today, and the tendencies of the unrestrained youth of this generation, there appears to be much reason for the continuance of parental control during the child's minority, and that such control should not be embarrassed by conferring upon the child a right to civil redress against the parent . . . . In our opinion, much reason exists for maintaining the

2. Employers and co-employees, for bodily injury claims by employees;[16]

> sound public policy, which, as stated, underlies the rule which denies such redress.

Smith v. Smith, 81 Ind. App. 566, 569-70, 142 N.E. 128, 129 (1924). Because the parent cannot be liable to the child, the parent cannot be a nonparty for purposes of allocation of fault in a suit by the child against others. However, in an action against others by a child who was emancipated at the time of the injury, any fault of the parent which caused the injury must be included in the apportionment scheme. Also, there is no immunity for the noncustodial parent in actions by the child. Buffalo v. Buffalo, 441 N.E.2d 711 (Ind. Ct. App. 1982).

In the converse relationship, there probably is no immunity of an unemancipated child in a tort action by a parent. Young v. Wiley, 183 Ind. 449, 107 N.E. 278 (1914); McKern v. Beck, 73 Ind. App. 91, 126 N.E. 641 (1920). Thus, in an action by a parent against others, the fault of a child who contributed to cause the injury should be included in the apportionment scheme. The most common accident scenario is where a parent is a passenger in an automobile being operated by the child and a collision occurs. If the collision was caused jointly by the fault of the child-driver and a second driver, the fault of the child would have to be considered in the parent's action for damages against the second driver.

The withering of the parent-child immunities was suggested by the 1984 General Assembly in its amendment to the statute dealing with liability to guest passengers which provided:

> The owner, operator or person responsible for the operation of a motor vehicle is not liable for loss or damage arising from injuries to or the death of:
>
> (1) His parent;
>
> * * *
>
> (3) His child or stepchild; resulting from the operation of the motor vehicle while the parent . . . child or stepchild . . . was being transported without payment therefor . . . unless the injuries or death are caused by the wanton or willful misconduct of the operator, owner, or person responsible for the operation of the motor vehicle.

IND. CODE § 9-3-3-1 (Supp. 1987). The effect of the guest statute on parent-child immunity and comparative fault was discussed in Farmers & Merchants State Bank v. Norfolk & W. Ry. Co., 673 F. Supp. 946, (N.D. Ind. 1987) ("parent *may* be liable to a guest child who is injured when the parent driving the car willfully or wantonly causes such injury." (emphasis in original)).

The interplay between the apportionment scheme of comparative negligence and interspousal and intrafamily immunities of the common law was the critical issue in two leading Kansas cases. Brown v. Keill, 224 Kan. 195, 580 P.2d 867 (1978), and Miles v. West, 224 Kan. 284, 580 P.2d 876 (1978). In *Miles*, the minor plaintiffs argued that the negligence of their father, as the operator of an automobile which collided with defendant's vehicle, could not be considered in the determination of comparative negligence. *Id.* at 287, 580 P.2d at 879. The Supreme Court of Kansas in rejecting this argument, stated:

> The goal of determining fault of all the parties responsible for causing or contributing to the collision or occurrence is to allow each party to be joined in action, even if he is immune or judgment-proof.
>
> The foregoing effectively disposes of plaintiffs' arguments on interspousal tort immunity and intrafamily immunity as they apply to this case. Recognizing

3. Governmental entities and their employees, for claims arising out of certain acts, including discretionary acts, and conditions.[17]

Because these classes of immune tortfeasors cannot be considered in the allocation of fault, all the nonimmune joint tortfeasors, including a plaintiff tortfeasor, share the burden of the fault of an immune tortfeasor in proportion to their respective percentages of fault.[18] Such allocation emanates from the Indiana provision that the fault of all tortfeasors, whether they are parties or nonparties, is to be considered in the allocation of fault by the trier of fact, except that the fault of immune tortfeasors may not be considered.[19]

One of the first reported opinions addressed the effect of the involvement of immune tortfeasors on the apportionment of fault. In the consolidated cases of *Hill v. Metropolitan Trucking, Inc.* and *Clemons v. Metropolitan Trucking, Inc.*,[20] the court ruled that co-employees of the plaintiffs could not be pleaded as nonparty tortfeasors, and could not be the subject of an apportionment of fault.[21] The defendants, whose truck struck two state highway department workers, attempted to assert the fault of each worker in the suit by the other. In both actions the defendants attempted to assert the negligence of a third worker and a state trooper who were at the scene of the accident. The court easily

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> the existence of interspousal tort immunity [citation omitted], and assuming, but not admitting, the existence of intrafamily immunity in this state, plaintiffs' arguments have no merit.

Id. at 288, 580 P.2d at 879-80. The Court affirmed the diminution of the jury awards to the minor children by 40%, the percentage of fault which the jury assigned to their father. Remarkably, the Kansas court resisted the temptation to abolish intrafamily immunity, if indeed such immunity existed, and simply ignored such immunity in the comparative fault allocation.

[16]The Indiana Workmen's Compensation Act bars civil actions by an employee against his employer and against co-employees. IND. CODE § 22-3-2-6 and § 22-3-2-13 (1982). Also, the employer is expressly excluded as a nonparty by the Comparative Fault Act. IND. CODE § 34-4-33-2(a) (Supp. 1987).

[17]Indiana has adopted a comprehensive Tort Claims Act barring claims against governmental entities and their employees with respect to the performance of discretionary functions and other specified acts and conditions. IND. CODE § 34-4-16.5-3 (1982). Sovereign immunity generally does not exist with respect to the ministerial acts of the government and its employees. Department of Mental Health v. Allen, 427 N.E.2d 2 (Ind. Ct. App. 1981). *See* Discussion of the State as tortfeasor, Section III *infra*.

[18]For example, in the hypothetical case in which the plaintiff is 20% at fault, the nongovernmental tortfeasor is 30% at fault, and the immune governmental tortfeasor 50% at fault, the plaintiff's damages theoretically would be reduced by 40%, and the nongovernmental tortfeasor would be liable for 60% of such damages.

[19]*See supra* note 12 and accompanying text.

[20]659 F. Supp. 430 (N.D. Ind. 1987).

[21]*Id.* at 435.

disposed of such purported nonparty defenses, reasoning that none of the nonparty employees, including the state trooper, were within the statutory definition of nonparty because none were or could be liable to the claimants.[22] The court looked to the Indiana Workmen's Compensation Act, which provides the exclusive remedy for a claim for injury or death against both an employer and a co-employee. Since there was no civil remedy available to the plaintiffs against the other state highway employees, or against the co-employee state trooper, they were immune from civil liability. Therefore, they could not be "liable to the claimant" and did not qualify as nonparties within the contemplation of the Comparative Fault Act.[23]

The opinion of the District Court in *Hill*, with respect to immunity from civil suit by reason of the exclusive remedy provision of the Workmens' Compensation Act, is consistent with both the letter and the rationale of the Act.[24] That is not to say that it is consistent with the spirit of comparative fault, for such result shifts the burden of the fault of the alleged immune tortfeasors to either the plaintiff, or the defendant, or both, depending upon their culpability relative to each other.

For example, if the plaintiffs' decedents were entirely free from fault, the non-immune defendant was guilty of 10% of the total fault, and the immune tortfeasors were collectively guilty of 90% of the total fault, the defendant would be liable for 100% of plaintiffs' damages. Such result would be a gross deviation from the objective of allocation of financial burden in proportion to fault, but would satisfy the objective of providing for full compensation to the plaintiff. On the other hand, if the plaintiffs' decedents were found to be 20% at fault, and the non-immune defendants were also 20% at fault, then they would share equally the burden caused by the 60% fault of the immune tortfeasors. Although

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[22]*Id.* at 434-35.

[23]*Id.*

[24]The court in *Hill* perfunctorily contemplated a second reason for the exclusion of the state employees from the apportionment scheme. It observed that the governmental employees were within the protection of the 180-day notice provision of the Tort Claims Act, and stated:

> The record does not suggest that the [plaintiffs] gave such notice; accordingly, the record does not reflect that the would-be nonparties are or may ever be liable to the plaintiffs.

659 F. Supp. at 435. The recitation infers the reasoning that if a plaintiff cannot perfect a claim against an otherwise qualified nonparty by reason of having allowed a limitations period to expire, such potential defendant or nonparty cannot be considered in the apportionment of fault by the trier of fact. The conclusion is in direct conflict with the better-reasoned opinion of the Southern District in *Huber v. Henley*. *See infra* text accompanying note 31.

this result seems to be more just, it remains violative of the spirit of comparative fault.

Whether the deprivation of the statutory nonparty defenses[25] is justifiable involves a judgment as to the social utility of such immunities, and the propriety of universal adherence to the basic principle of fault allocation. As evidenced by the Tort Claims Act and the Workmen's Compensation Act, the Indiana General Assembly presumably has concluded that sound public policy dictates the retention of the immunities of governmental entities and their employees for certain acts, and the immunity of the employer and co-employees from civil actions. Neither the legislature nor the courts have directly addressed the retention of parental immunity in the context of comparative fault. Parental immunity remains in the common law of Indiana, but the critical issue is whether it should be engrafted onto the comparative fault system. If indeed preeminence is to be given to the basic principle of fault allocation, then the fault of familial nonparties must be included in the fault apportionment system.[26]

It must be stressed that the allocation of fault to immune tortfeasors would not require the abolition of such immunities. The burden of such immunities would merely shift to the plaintiff. Although this shift in the burden obviously would not accomplish the goal of full compensation to the injured plaintiff, it would comport with the principle of fault allocation because the immune parties would be considered by the trier of fact. On the other hand, the exclusion of immune tortfeasors from the apportionment scheme shifts the burden of their fault to all the other tortfeasors, including the plaintiff tortfeasors, in the same ratio of their relative fault to each other. Under this scenario, neither of the primary objectives of comparative fault is realized.

III. Treatment of the State as a Tortfeasor

The state, its political subdivisions, and their employees are expressly exempted from the provisions of the Indiana Comparative Fault Act, but remain liable for their nonimmune torts.[27] The traditional defenses

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[25]Ind. Code § 34-4-33-10 (Supp. 1987).

[26]*See supra* note 13.

[27]Section 8 of the Act provides, "This chapter does not apply in any manner to tort claims against governmental entities or public employees under IC § 34-4-16.5." Ind. Code § 34-4-33-8 (Supp. 1983).

The reference in the statute is to the Indiana Tort Claims Act, which, in its salient provisions, defines the immunities for discretionary acts and certain other acts and conditions, and recodifies the requirement for filing a notice of tort claim within 180 days of the alleged tort. Ind. Code § 34-4-16.5-7 (1982). Such notice is a condition precedent to the right of recovery against the political subdivision and its employees. In effect, it provides a 180-day limitation period on claims against governmental tortfeasors. *See infra* note 36 and accompanying text.

of contributory negligence and incurred risk remain available and constitute a complete bar to claims both by and against governmental tortfeasors.[28]

The immediate concern of the practicing bar upon enactment of the comparative fault system was whether the fault of governmental tortfeasors could be pleaded by a nongovernmental defendant in order to reduce that defendant's apportioned share of the plaintiff's damages, even though governmental tortfeasors are expressly excluded from the comparative fault scheme. This concern grew mostly out of the recognition that automobile injury cases have comprised a substantial share of tort litigation, and that substandard highway design and maintenance are often alleged to be causal factors in automobile accidents.

The plaintiffs' bar wanted to read the provision excluding governmental tortfeasors to prohibit a defendant from pleading the fault of the government as a nonparty tortfeasor, because to permit such consideration by the trier of fact would require the cumbersome inclusion by the plaintiff of a "contributory defense" defendant and a "comparative defense" defendant in the same action, and perhaps even in the same trial. Moreover, highway design and maintenance cases against the government are usually more complicated to prove, often requiring special expert testimony and evidence, in contrast to the relatively simple automobile negligence case against a defendant motorist. Furthermore, the inclusion of the state in the apportionment system would deprive the plaintiff of a substantial part of his recovery if he did not act within the 180-day notice period set out in the Indiana Tort Claims Act.[29] Finally, such inclusion would permit the nongovernmental defendant to reduce his judgment exposure by the percentage of fault attributed to both the governmental tortfeasor and the plaintiff; yet, any percentage of fault on the part of the plaintiff would completely bar a recovery by plaintiff of those damages which are attributable to the fault of the government. In light of these considerations, the plaintiffs' bar would have preferred to ignore the governmental tortfeasors in the comparative fault case, especially in the apportionment of fault by the trier of fact. Indeed, each of these fears was justified, since the application of the act would be made exceedingly more complicated by the inclusion of the governmental tortfeasor in a case in which there were private defendants.

Of course, the defense bar and insurance industry argued that the exlusionary provision should be interpreted consistently with the basic principle of comparative fault. That is, the fault of the government

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[28]*See* Wilkins, *supra* note 6, at 729.
[29]*See supra* note 22.

should indeed be apportioned along with all the other tortfeasors. To ignore the fault of the government, whether or not it could be a defendant, would cause the burden of the governmental tortfeasor's fault to be borne, in whole or in part, by each liable defendant;[30] yet, the plaintiff could recover damages against the governmental tortfeasors, perhaps in a separate action. Such result would have been an obvious violation of the fundamental principle of apportionment of liability according to fault. The defense bar was not concerned that the inclusion of the government's conduct in the apportionment scheme, while measuring its liability for damages by traditional tort rules, would present very special problems for the plaintiff. While the defendants' argument for inclusion of the governmental defendant for fault apportionment purposes would serve the basic principle of comparative fault, it would deprive a plaintiff tortfeasor of that percentage of his damages attributable to the fault of the governmental tortfeasors.[31]

While the respective arguments of the plaintiffs' bar and the defense bar came into focus early, the state's initial perception of the exclusionary provision was not so clear. The State of Indiana simply argued in the legislature that it would be subjected to unreasonably burdensome costs were it to be included in the comparative fault system, and managed to have itself written out of the act.[32]

The state's position came into focus in the second reported opinion under the Act, *State v. Schuetter*,[33] a motor vehicle collision/highway

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[30]If the government's fault were ignored in the apportionment scheme, the burden of the government's fault would also be shared by a plaintiff tortfeasor in the same ratio that plaintiff's fault bore to the total fault of all other liable tortfeasors. Theoretically, assuming 50% of the fault were attributable to the state, but were ignored in the apportionment scheme, a plaintiff 20% at fault would bear 20% of the government's fault and a defendant 30% at fault would bear 30%. Plaintiff's actual recovery on a finding of $100,000 total damages would be $60,000.

[31]Assume that the trier of fact were to apportion 10% of the total fault to the plaintiff, 40% to the private defendant, and 50% to the governmental defendant. The plaintiff would recover only 40% of his total damages, since the finding of contributory fault on the part of the plaintiff would bar recovery of any damages against the governmental defendant.

[32]The proposed act was subjected to many compromises during the legislative process. The opposition by the State of Indiana was voiced after the bill had already passed the Senate, and had cleared the second-reading amendment stage on the floor of the House. At that point, the Attorney General informed the House Speaker that "passage of the bill would cost the State of Indiana millions of dollars each year." On the strength of that unsupported assertion, and as a matter of political expediency, governmental entities were legislatively excluded from its coverage. Bayliff, *supra* note 6, at 865.

[33]503 N.E.2d 418 (Ind. Ct. App. 1987). The claim of plaintiff arose from property damage to plaintiff's truck, sustained in a two-vehicle collision with defendant's automobile on an interstate highway. The defendant asserted by answer to the complaint that the

design case. The state argued that it could not even be sued in the same legal action with the defendant motorists because the plaintiff's right of recovery against those defendants was governed by comparative fault, which plan was not to apply "in any manner" to the State.[34] The court of appeals swept the state's argument aside and held that there is no prohibition against inclusion of both a private defendant and a governmental defendant in the same action. The court recognized that the action was one against joint tortfeasors, differing only in the manner in which their alleged negligence is to be treated at trial.[35] The fears of the plaintiffs' bar thus became a reality. The impact upon the government is not so clear.

The second issue in *Schuetter* was whether the granting of a separate trial of the claim against the governmental defendant was permissible. The court of appeals held that the granting of separate trials is within the discretion of the trial court and that since there was no showing of an abuse of that discretion, the separate trial ruling should stand.[36]

The trial posture of *Schuetter* following the appeal vividly illustrates the unworkability of excluding governmental tortfeasors from the comparative fault system and may even serve to increase the number of suits against governmental tortfeasors. If separately trying claims against governmental tortfeasors develops into a trend, it is possible that the parties within the comparative fault system will benefit from the exclusion of governmental tortfeasors. Given the virtual impossibility of intelligibly instructing the jury when both governmental and nongovernmental defendants are joined at trial, it is likely that courts will look favorably upon separate trials. As a result, the ground is fertile for a plaintiff who is free from fault to recover *all* his damages from a governmental defendant.[37]

A likely scenario under which recovery of all damages against the government would occur is where a faultless plaintiff, with the cooperation of the nongovernmental defendant, causes the suit against the governmental defendant to be tried first. If the plaintiff is successful

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collision was caused, in whole or in part, by the state's failure to keep the roadway clear of sand and debris, and by its failure to provide adequate access onto the state highway. Thereupon, plaintiff amended the complaint to include the state as a defendant. The state moved to dismiss and, in the alternative, for a separate trial. Upon denial of its motion to dismiss, the State perfected an interlocutory appeal. *Id.* at 419.

[34]*Id.* at 420. *See* Ind. Code § 34-4-33-8 (Supp. 1987).

[35]503 N.E.2d at 420.

[36]*Id.* at 421.

[37]The political subdivision and its employees enjoy a liability cap of $300,000 for injury or death of one person in any occurrence, which would frustrate collection of all damages from the governmental tortfeasor in cases of catastrophic loss. Ind. Code § 34-4-16.5-4 (1982).

in that suit, he can then collect his entire judgment against the government through the application of the doctrine of joint and several liability. A variation of the scenario occurs where the nongovernmental defendant, a joint tortfeasor with the government, lends an agreed sum to the plaintiff in return for a covenant not to sue. Under such an agreement, plaintiff would be obligated to repay the loan only upon collection of a settlement or judgment against the government.[38]

In light of the opportunity for such abusive tactics against the state, it is curious that it was the state which moved for the separate trial in *Schuetter*.[39] The only logical justification is that the state believed that the plaintiff would not proceed to trial due to the state's minimal exposure to liability.

It is apparent that the lofty goals of the comparative fault system are frustrated where a governmental entity is a joint tortfeasor with a nongovernmental defendant. The exclusionary clause in the Indiana Act[40] provides no assurance of either apportionment of the liability in proportion to fault, or of full compensation to the plaintiff for his injuries. The system is unnecessarily complicated, and multiplicity of trials is encouraged. Moreover, since one must be skeptical of the validity of excluding the state from the comparative fault system on the ground that it would be unreasonably costly, there is scant justification for the exclusion. Further, the consensus of the trial bar seems to be that the abrogation of joint and several liability by the comparative fault system is more valuable to a defendant than such traditional tort defenses which

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[38]For a discussion of the use of loan receipt agreements, see note 3 *supra*.

One might be tempted to reason that the state's motion for a separate trial in *Schuetter* was motivated by the presence of a meritorious contributory negligence defense against the plaintiff, but considerations of litigation costs aside, joint trial would enhance the contributory negligence defense. Since the jury is required to specially find the percentage of negligence of the plaintiff with respect to the claim against the non-governmental defendant, the advantage of a finding of only a small percentage of the total fault on the part of the plaintiff would establish the contributory negligence defense and result in a verdict in favor of the government.

In contrast, in the separate trial scenario, where the claim against the non-governmental defendant happens to be tried first, the government should not be able to take advantage of an allocation by the jury in the first trial of some percentage of comparative fault to the plaintiff. Obviously, the element of mutuality of estoppel is lacking between the two trials. Otherwise, the government would not be estopped from resisting the proof of its negligence at trial, even though the jury in the first trial may have assigned some fault to the nonparty government.

Mutuality of estoppel is an essential element of the "claim preclusion" branch of the doctrine of *res judicata*. State v. Speidel, 181 Ind. App. 448, 392 N.E.2d 1172 (1979).

[39]503 N.E.2d at 419.

[40]*See supra* note 22.

have been retained by the governmental defendants.[41] The state would be well advised to make the same trade.

The ills visited upon the tort system by excluding governmental tortfeasors from the comparative fault system are numerous. Coupled with the lack of any proof to merit such exclusion, it is not difficult to conclude that the Act should be amended to include governmental tortfeasors in Indiana's comparative fault system.

IV. The Inadvertently Omitted Tortfeasors

The failure in a comparative fault suit to include a joint tortfeasor who is liable to the plaintiff is one of the most dreaded omissions of the plaintiff's lawyer. Under the traditional tort system, the availability of joint and several liability rendered such omission inconsequential so long as one joint tortfeasor was successfully sued. Under the unique provision of the Indiana Comparative Fault Act, however, such omission causes a diminution in the plaintiff's recovery in precisely that percentage of plaintiff's total damages which is attributed to the fault of the omitted nonparty tortfeasor.[42] Once the period of limitations for suing that tortfeasor has expired, that share of plaintiff's damages is forever lost.

This was precisely the outcome in the recent case of *Huber v. Henley*.[43] In *Huber*, one defendant pleaded that the fault of the co-defendants and the fault of the nonparty Indiana Department of Highways caused the injuries to the plaintiff. Unfortunately for the plaintiff, the defendant asserted this defense in an amended answer filed after the expiration of the 180-day notice period to the state, a condition precedent to recovery on claims against the state imposed by the Indiana Tort Claims Act.[44] The primary issue presented in *Huber* was whether a defendant should be permitted to amend an answer in which he asserts for the first time the fault of a nonparty tortfeasor who is no longer amenable to suit.[45] The Southern District ruled that such amendment is permissible because the Act provides that, while a defendant must plead

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[41] *See* Eilbacher, *supra* note 3, at 907.

[42] Ind. Code § 34-4-33-5(a)(4) & (b)(4) (Supp. 1987).

[43] 656 F. Supp. 508 (S.D. Ind. 1987).

[44] *Id.* at 509. *See supra* note 22. *See also* Huber v. Henley, 669 F. Supp. 1474, 1477-79 (S.D. Ind. 1987) (Huber II). In *Huber II*, the court contrasted a plaintiff who had failed to give notice to the state under the Indiana Tort Claims Act, thereby forfeiting his right to recovery with a plaintiff whose suit against the state was barred by a statute of repose. The court correctly noted that in the first instance the state could be a nonparty under the Comparative Fault Act; however, the state in the second instance could not be a nonparty because it was not "a person who is, or may be, liable" to the plaintiff. 669 F. Supp. at 1479.

[45] 656 F. Supp. at 510.

the statutory nonparty defense in the original answer if it is known, the defense may be pleaded by amended answer "with reasonable promptness,"[46] once the defendant has actual knowledge of the defense.[47]

Ordinarily, the operative provision for the naming of a nonparty tortfeasor is the provision which recites that, if the defendant is served with summons more than 150 days prior to the expiration of the period of limitations, the nonparty defense must be pleaded not later than 45 days before such expiration.[48] Such scheme is calculated to give the plaintiff time to evaluate the claim against the alleged nonparty tortfeasor and to join such tortfeasor as a party defendant. However, such provision was not at issue in *Huber*, since the assertion by the amended answer was made more than 45 days before the expiration of the applicable two-year period of limitations, although after the expiration of the 180-day claim notice period.[49]

The other significant issue in *Huber* is whether the comparative fault of the state could be asserted at all, since the state could no longer be "liable to the claimant," because of the expiration of the 180-day notice period.[50] The court had no difficulty in identifying the distinction between a tortfeasor who cannot be joined if the applicable limitation period had not expired and the tortfeasor who cannot be joined because of an immunity. Accordingly, the court held that the state, although immune from liability to the plaintiff, must be included in the apportionment scheme as a nonparty tortfeasor under the Comparative Fault Act.[51] Interestingly, the court justified its conclusion by noting that the pro-

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[46]The act allows for the defense by amended answer:

> A nonparty defense that is known by the defendant when he files his first answer shall be pleaded as a part of the first answer. A defendant who gains actual knowledge of a nonparty defense after the filing of an answer may plead the defense with reasonable promptness.

Ind. Code § 34-4-33-10(c) (Supp. 1987). The provision limits the pleading of the nonparty defense at a time close to the expiration of the period of limitations applicable to the claim against such nonparties, granting discretion to the trial court to alter the time limitations to achieve a fair result to both parties.

[47]656 F. Supp. at 512. The court's decision to allow such an amendment was not difficult because the 180-day notice period had already expired at the time of filing the original answer. *Id.*

[48]Ind. Code § 34-4-33-10(c) (Supp. 1987).

[49]656 F. Supp. at 512 n.5.

[50]*Id.* at 510-11. The plaintiff argued that the state was "immune" since it could no longer be sued, because the plaintiff had not given notice of the tort claim to the state within 180 days of the injury. As to the lack of common identity between an immune tortfeasor and a statutory nonparty, *see supra* note 20 and accompanying text. By definition, the terms are mutually exclusive. However, the state is not immune as to its ministerial acts of negligence in highway maintenance. Ind. Code § 34-4-16.5-3 (1982).

[51]656 F. Supp. at 511. *See supra* discussion of *Huber II*, note 44.

visions of the Act evidenced a legislative intent to favor the principle of strict apportionment of fault among all tortfeasors over the objective of fully compensating plaintiffs.[52]

A contrary conclusion was reached by the Northern District in *Hill v. Metropolitan Trucking Inc.*,[53] which reasoned that, if an applicable limitation period has expired as to a tortfeasor who has not been sued, then such tortfeasor may not be included in the apportionment of fault by the trier of fact. As in *Huber*, the plaintiffs apparently had not given the required 180-day notice to the governmental tortfeasors. The *Hill* court observed that, since such tortfeasors could never again be liable to the plaintiffs because of such omission, none qualified as a nonparty who "is or may be liable to the claimants," and, therefore, must be ignored in the apportionment of fault.[54] The court failed to make the *Huber* court's distinction between a tortfeasor who is or may be liable at the time of the tortious conduct, but subsequently becomes free from liability because the plaintiff, either intentionally or inadvertently, permitted the limitation period to expire and a tortfeasor who can never be liable to the plaintiff because of a statutory or common law immunity.[55]

The reasoning in *Hill* is faulty. The court ignored the mandate of the legislature that the primary objective of the Comparative Fault Act is to allocate fault among all tortfeasors in direct proportion to the fault of each. To ignore a tortfeasor in the apportionment process simply because the applicable period of limitations or notice has expired would permit the plaintiff to manipulate the apportionment process and allow an otherwise liable tortfeasor to escape the assignment of fault. Whether the omission of timely notice was intentional or inadvertent, the result would be to shift the burden of the absent tortfeasor's fault to the other parties to the suit, contrary to the objective of the Act. Indeed, if the plaintiff's failure to give timely notice or to bring suit within the limitation period was inadvertent, the exclusion of such tortfeasor from fault apportionment would shift the burden of plaintiff's error to the defendant. Traditional notions of fairness compel the rejection of this result.

In contrast, the ruling in *Huber* allowing a defendant to name a tortfeasor as a nonparty after the expiration of some limiting period is sound. This result was obviously anticipated by the legislature, not necessarily with respect to the 180-day tort notice provision, but in the interplay with any applicable period of limitations. The plaintiff can

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[52]*Id. See also*, *supra* note 2.
[53]659 F. Supp. 431, 434-35.
[54]*Id.* at 435.
[55]*Compare Hill*, 659 F. Supp at 434-35 *with Huber*, 656 F. Supp. at 510-11.

protect against the inadvertent omission of tortfeasors by filing his suit more than 150 days before the limitation period expires. In such case defendant would be compelled to name all nonparty tortfeasors at least 45 days before expiration, thus giving plaintiff time to gather all liable tortfeasors into the legal action.[56]

Unfortunately, such protection for the plaintiff against the inadvertent omission does not exist with respect to the 180-day notice provision of tort claims against governmental tortfeasors. The potential deprivation to plaintiff of a part of his damages attributable to the government's share of the total fault is an injustice. However, the injustice is not in the provisions of the Comparative Fault Act. The injustice springs from the unrealistic 180-day notice provision of the Tort Claims Act.[57] The remedy does not lie in modification of the comparative fault system, but by re-evaluating the necessity for the tort claim notice provision.[58] As any defense counsel who has been employed by an insurance company to defend a governmental tortfeasor must concede, there is no substantial justification for the retention of the tort claim notice provision. The state or the municipal corporation has no greater need for such advance notice than does any other corporate defendant. The provision is too often simply a shield against liability for meritorious claims of citizen plaintiffs who have no knowledge of the notice requirement, or have been unable to identify the liability of the government in so short a time period. The need to satisfy *both* primary objectives of comparative fault—fair allocation of financial responsibility among all tortfeasors and fully compensating the injured plaintiff justifies the legislative abandonment of the notice provision of the Tort Claims Act, if not the immunities provided by it.

V. Avoidable Consequences Defense

The Indiana Act borrows liberally from the Uniform Comparative Fault Act.[59] The definition of "fault" is essentially taken from the Uniform Act, except that the concepts of strict liability, breach of

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[56]Ind. Code § 34-4-33-10(c) (Supp. 1987).

[57]*See supra* note 22.

[58]The Indiana courts have repeatedly held that the failure of a claimant to give notice of a tort claim against a political subdivision is a complete bar to suit, even in instances in which the governmental entity had had actual notice of the incident giving rise to the tort claim, and conducted its own investigation of the incident. Geyer v. City of Logansport, 267 Ind. 334, 370 N.E.2d 333 (1977); City of Indianapolis v. Uland, 212 Ind. 616, 10 N.E.2d 907 (1937); Teague v. Boone, 442 N.E.2d 1119 (Ind. Ct. App. 1982).

[59]Unif. Comparative Fault Act, 12 U.L.A. 39 (1979).

warranty, and the misuse defense are omitted to reflect their exclusion from the Indiana comparative fault scheme.[60]

Among the array of acts and omissions which constitute "fault" is the "unreasonable failure to avoid an injury or to mitigate damages."[61] The phrase suggests two distinct defenses. The failure to avoid an injury refers to pre-tort conduct, while the defense of failure to mitigate damages looks to post-tort conduct, formerly a distinction which provided for a cumbersome analysis.[62] The latter was traditionally known as the avoidable consequences doctrine,[63] and was pleaded as an affirmative defense

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[60]The original version of the Indiana Act was more comprehensive. By the 1984 amendment, claims based upon the legal theories of strict liability and breach of warranty were expressly excluded from the Act. IND. CODE § 34-4-33-13 (Supp 1987). The act is rendered far more difficult in its application by such exclusion in the products liability trial which often is based upon those two theories, as well as a negligence theory. *See, e.g.*, Davidson v. John Deere & Co., 644 F. Supp. 707 (N.D. Ind. 1986). The ability to instruct the jury intelligibly is questionable when those three theories are combined.

[61]The full definition of fault is as follows:

> (a) As used in this chapter:
> 'Fault' includes any act or omission that is negligent, willful, wanton, or reckless toward the person or property of the actor or others, but does not include an intentional act. The term also includes unreasonable assumption of risk not constituting an enforceable express consent, incurred risk, and unreasonable failure to avoid an injury or to mitigate damages.

IND. CODE § 34-4-33-2 (Supp. 1987).

[62]*See* State v. Ingram, 427 N.E.2d 444 (Ind. 1981), a case in which the availability of the "defense" of failure to wear seat belts is analyzed. The court seemed to struggle with whether the failure to wear restraints supported a defense of failure to mitigate damages, because such failure was a pre-tort act. *Id.* at 448. A pre-tort act or omission ordinarily gives rise to an affirmative defense, which, in the former practice, constituted a complete bar to recovery under the traditional defenses of contributory negligence or incurred risk. In contrast, a post-tort error would simply result in a reduction of damages to the plaintiff on the theory that avoidable damages are not proximately caused by the defendant's wrongdoing. The distinction is now meaningless, since both pre-tort and post-tort errors are combined in the definition of fault, the natural function of which is to reduce damages.

[63]*Id.* at 447. The court stated:

> The rule of avoidable consequences comes into play *after a legal wrong has occurred*, but while some damages may still be averted, and bars recovery for such damages.

Id. (emphasis in original) (quoting W. PROSSER, HANDBOOK OF THE LAW OF TORTS, ch. 11, § 65 at 243 (4th ed. 1971)).

The definition of the avoidable consequences doctrine, as established at Restatement (Second) of Torts § 918 (1971), was recognized:

> Avoidable consequences. (1) Except as stated in Subsection (2), one injured by the tort of another is not entitled to recover damages for any harm that he could have avoided by the use of reasonable effort or expenditure after commission of the tort.

It was concluded by the court that such doctrine was not applicable to the so-called seat belt defense, which arises out of a pre-tort omission. 427 N.E.2d at 447.

as a matter of avoidance under Trial Rule 8.[64]

Since the defense of unreasonable failure to mitigate damages now appears simply as "fault," it fits quite neatly into the comparative fault procedure reducing those damages of a plaintiff which are attributable to his own acts and omissions, irrespective of whether such act or omission was pre-tort or post-tort. Such defense was addressed by the court of appeals in the recent case of *Persinger v. Lucas*.[65] The defendant in *Persinger* argued that the accrual of storage charges for a damaged automobile which had been rendered a total economic loss in a collision constituted an unreasonable failure to mitigate damages. The court agreed that a plaintiff has a duty to mitigate storage cost damages and that an unreasonable failure to mitigate constitutes fault under the Act, to be compared with other forms of fault contributing to the injury.[66] The *Persinger* case is not remarkably instructional in terms of explanation of the Indiana Act because the issue involving comparative fault was given to easy disposition.[67] However, the case reinforces the conclusion that the Indiana comparative fault scheme is simple in application because it deals more easily with doctrines which tended to be analytically elusive under the former practice.

VI. Pleadings and Special Findings

In *Walters v. Dean*,[68] the first reported decision after adoption of the Act, the issue on appeal was whether the trial court properly applied the provisions of the Comparative Fault Act. The trial court found that the plaintiff was 100% at fault for the damages to his own automobile although the defendant had not pleaded the fault of the plaintiff in his answer. The defendant did, however, file an affirmative defense asserting that the *sole* cause of the collision was the fault of a nonparty tortfeasor—the plaintiff's son.[69] In focusing on the quantum of proof to support

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[64]Ind. R. Tr. P. 8.

[65]512 N.E.2d 865 (Ind. Ct. App. 1987).

[66]*Id.* at 871.

[67]The court of appeals, while finding that the plaintiff had a duty to mitigate storage cost damages for the demolished automobile, affirmed the finding of 0% comparative fault on the part of the plaintiff on the evidence that the plaintiff was financially unable to make other arrangements for the disposition of the automobile. The court correctly reasoned that the burden of proof of failure to mitigate was that of the defendant, and the defendant failed to show what plaintiff could have done to mitigate damages that would not have required the expenditure of unavailable funds. *Id.*

[68]497 N.E.2d 247, 249 (Ind. Ct. App. 1986).

[69]*Id.* at 249. The issue of the existence of a possible immunity of the son was not raised. *See* discussion of intrafamily immunities in Indiana *supra* note 13.

It is not necessary to plead that the *sole* cause of an injury is the fault of a person

the judgment, the court did not comment on the apparent pleading discrepancy and no such error was assigned by the plaintiff. In affirming the judgment the court of appeals held, seemingly reluctantly, that the trial court could have found under the evidence that the plaintiff was negligent and that plaintiff's son and the defendant were entirely free from fault.[70]

There are two important procedural considerations raised in *Walters*. First, it may be fairly inferred from the opinion that it is unnecessary for the defendant to plead in his answer the comparative fault of the plaintiff in order to put the plaintiff's fault in issue.[71] Such is not the case, however, with respect to the comparative fault of a nonparty tortfeasor.[72] The court in *Walters* observed, "it is our opinion that allocation of nonparty fault is to be made only in those cases where the nonparty defense is specially pleaded by a named defendant."[73]

The court of appeals did not make a similar observation with respect to the assertion of the fault of the plaintiff as an affirmative defense; yet, it considered appropriate a finding of 100% fault on the part of plaintiff. Such a distinction between the two defenses probably does not represent a departure from the pleading requirements set forth in the Indiana Rules of Trial Procedure. Rule 8(C) omits both contributory negligence and assumption of risk from the array of affirmative defenses which must be specially pleaded, and Rule 9.1(A) provides that in a negligence action, such defenses may be pleaded by the denial of the allegation.[74] The Federal Rules of Civil Procedure, on the other hand, expressly require that assumption of risk and contributory negligence be asserted as affirmative defenses.[75] Thus, *Walters* seems to stand for the proposition that the defendant need not specially plead the fault of the plaintiff in an Indiana court.[76] In contrast, the defense must still be pleaded in a federal action in which Indiana substantive law is applied.[77]

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who is neither a party nor a statutory nonparty. Such a contention encompassed in the general denial of the allegations that the conduct of the defendant was the proximate cause of plaintiff's injury. Hill v. Metropolitan Trucking Inc., 659 F. Supp. 430, 435 (N.D. Ind. 1987).

[70]497 N.E.2d at 254.

[71]*See supra* note 45.

[72]The Act expressly provides that a nonparty defense must be pleaded in defendant's answer. IND. CODE § 34-4-33-10(c) (Supp. 1987).

[73]497 N.E.2d at 253.

[74]IND. R. TR. P. 8(C).

[75]FED. R. CIV. P. 8(C).

[76]Due caution dictates that the matter of contributory fault be raised at the pre-trial conference, when "simplification of the issues" is undertaken, and included in the pre-trial order. *See* IND. R. TR. P. 16.

[77]*See supra* note 48 and accompanying text.

Another important procedural issue raised by the opinion in *Walters* is whether, in a bench trial, the court should include in its judgment the mathematical calculation of its apportionment of fault, in the absence of a request for special findings by a litigant. Of course, in *Walters*, the judgment was negative.[78] If the trial court had not included in its ruling on the motion to correct errors its finding that "the plaintiff was 100% at fault,"[79] it appears doubtful that the case would have been remanded for further findings. The court of appeals probably would have affirmed on the basis that there was sufficient evidence for the trial court to conclude that one of the following was found: (1) the defendant was not liable; (2) plaintiff's son was 100% at fault; or (3) plaintiff was at least 51% at fault. The court could have justified any of these findings under the oft-cited rule that a judgment will be affirmed on appeal, if it is supportable on any ground.[80]

There is no admonition in the Act that in a bench trial, the court make a specific finding of the percentages of fault.[81] In a jury trial, however, the Act expressly provides that the jury be furnished with verdict forms which require the disclosure of both the percentage of fault charged against each party and the calculations made in arriving at their final verdict.[82]

The issue then becomes whether the court, in a hypothetical bench trial, may secretly find that the plaintiff's damages are $100,000, that the plaintiff is 50% at fault, that the defendant is 25% at fault, and that the nonparty tortfeasor is 25% at fault, and simply enter a general judgment for the plaintiff for $25,000. Based upon traditional rules, such general judgment may not be reversed if neither party had requested the court to find the facts specially,[83] and if there was sufficient evidence to support the judgment.[84] Such a general finding was permissible before

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[78]497 N.E.2d at 254.

[79]*Id.* at 252.

[80]Devine v. Grace Construction and Supply Co., 243 Ind. 98, 181 N.E.2d 862 (1962). If an inference of fact *could* be inferred from the evidence, and proceeds logically from the evidence, the judgment will not be overturned on appeal. Hyman v. Davies, 453 N.E.2d 336 (Ind. Ct. App. 1983).

[81]The act merely requires that the trial court "shall make its award of damages according to the *principle* applicable to the jury trials." IND. CODE § 34-4-33-5(c) (1984) (emphasis added).

[82]IND. CODE § 34-4-33-6 (1984).

[83]Rule 52(A), of the Indiana Rules of Trial Procedure, provides that the trial court is not required to find the facts specially and state its conclusions therefor, unless requested in writing by a party.

[84]The virtual impossibility of reversal of a trial court upon general findings is well established. The Indiana Court of Appeals stated:

> We are not at liberty to re-weigh the evidence or to substitute our opinion for

the adoption of comparative fault, and there is nothing in the Act which precludes such a general finding in a comparative fault bench trial. However, it cannot be denied that a trial court would do a great disservice to the litigants by such a scant judgment order. Rule 52 contemplates that a court may make special findings on its own motion.[85] It is clear that the Act must be amended to require a trial court, sitting without a jury, to make at least the same findings that are required of a jury. In the interim, the trial lawyer must remember to protect the record by filing a request for special findings.

Another interesting pleading issue was presented in *Hill v. Metropolitan Trucking, Inc.*,[86] and a most sensible ruling resulted. As stated above, the primary issue in *Hill* was whether a defendant could assert the fault of an immune tortfeasor in diminution of that defendant's relative fault. The court granted the motion to strike such nonparty defenses because immune tortfeasors do not meet the test of a "person who is, or may be, liable to the claimant."[87]

The defendants further argued that even if they were not permitted to proceed with their statutory nonparty defenses, they should be permitted to assert that the immune tortfeasors' fault was the *sole* proximate cause of the casualty.[88] The court agreed that such assertion is available to the defendants, but that such was not an affirmative defense which must be pleaded.[89] The *Hill* court reasoned that under comparative fault the plaintiff retains the traditional burden of proving that the defendants' actions caused their injuries. Consequently, the defendants' general denial that they were a proximate cause encompasses the contention that plaintiff's injuries were the sole result of the fault of others. The court suggested that the contention is appropriately left to the evidence and to argument, and is not to be the subject of an affirmative defense.[90]

The discussion in *Hill* concerning the issue of proximate cause suggests a caveat in drafting the jury verdict form in an Indiana comparative

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> that of the finder of fact. . . . Where no findings of fact are made by the court, the general judgment is presumed to be based upon findings which are supported by the evidence. . . . We may not weigh conflicting evidence, but may consider only that evidence most favorable to the prevailing party. If there is evidence of probative value to sustain the judgment of the court, the judgment will not be disturbed. . . . Furthermore, when confronted with a general finding in favor of the plaintiff, we must affirm the judgment of the court if it is sustainable upon any legal theory which is supported by the evidence. . . .

Van Orman v. State, 416 N.E.2d 1301, 1304 (Ind. Ct. App. 1981) (citations omitted).

[85] IND. R. TR. P. 52(D).

[86] 659 F. Supp. 430 (N.D. Ind. 1987).

[87] *See supra* note 19 and accompanying text.

[88] 659 F. Supp. at 435.

[89] *Id.*

[90] *Id.*

fault case. The language of the Act seems to assume that the collective fault of the parties and liable nonparties caused plaintiff's injuries.[91] Such is not always the case, however, and the jury should not be compelled to find that only the fault of named tortfeasors caused plaintiff's injuries. The verdict form must allow a finding that no party, as well as a nonparty, was at fault. That is, the injury was caused by an "act of God," or by conduct which did not constitute legal fault. The courts must include in the critical jury instruction setting forth the methodology of applying the comparative fault principles, the following provision:

> In deciding this case you must first determine whether the defendant was at fault. If you find that the defendant was not at fault, or that any fault of the defendant was not a proximate cause of plaintiff's injuries, you must enter a verdict for the defendant and you need deliberate no further.

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[91]The Indiana Act is uniquely explicit as to the *seriatim* method to be employed by the jury in reaching its verdict. For example, in the case of a single defendant, the statute provides that the court *shall* instruct the jury to determine its verdict in the following manner:

> (1) The jury shall determine the percentage of fault of the claimant, of the defendant, and of any person who is a nonparty. The percentage of fault figures of parties to the action may total less than one hundred percent (100%) if the jury finds that fault contributing to cause the claimant's loss has also come from a nonparty or nonparties.
> (2) If the percentage of fault of the claimant is greater than fifty percent (50%) of the total fault involved in the incident which caused the claimant's death, injury, or property damage, the jury shall return a verdict for the defendant and no further deliberation of the jury is required.
> (3) If the percentage of fault of the claimant is not greater than fifty (50%) of the total fault, the jury then shall determine the total amount of damages the claimant would be entitled to recover if contributory fault were disregarded.
> (4) The jury next shall multiply the percentage of fault of the defendant by the amount of damages determined under subdivision (3) and shall then enter a verdict for the claimant in the amount of the product of that multiplication.

IND. CODE § 34-4-33-5 (Supp. 1987). In contrast, the Uniform Act merely provides that the court shall instruct the jury to answer special interrogatories as to (1) the total amount of plaintiff's damages, disregarding fault, and (2) the percentage of fault of all of the parties. The court then determines the award of damages. UNIF. COMPARATIVE FAULT ACT § 2, 12 U.L.A. 39, 41-42.

One respected commentator eschews special verdicts in comparative fault cases:

> More than twenty years of trial experience under both the pure and modified systems of comparative negligence, and having cases submitted on both general verdicts and interrogatories have convinced the writer that in many cases a general verdict is preferable. Juries have less trouble with a general verdict than with interrogatories. It more nearly effectuates their wishes.

H. WOODS, *supra* note 2, § 18.1 (2d ed. 1987). Such option is not available in Indiana.

Some injuries occur in the absence of legal fault by any entity. The jury should appreciate the availability of such a finding in the proper case. The suggested language would meet the needs of the defendants in the *Hill* case, and allow for the proximate cause argument.

VI. Conclusion

Only five cases construing Indiana's Comparative Fault Act have been reported since the Act took effect. As one robin does not a summer make, the effectiveness and the fairness of the Act cannot be judged upon the impact of these few cases. However, the signs are encouraging. In none of the cases was the court tempted to torture the provisions of the Act to achieve its own notion of substantial fairness.[92] Those shortcomings of the Indiana comparative fault system which have been identified arise typically not from the system itself, but from the interplay between the Act and some extraneous provision of Indiana law, such as the retention of certain immunities. Even if those injustices were cured, however, no easy solution is apparent with respect to handling the burden created by the insolvent tortfeasor.[93] Even the most callous of analysts must harbor a nagging guilt over placing the weight of that burden solely on the shoulders of the plaintiff. We must continue to re-examine the problem of the insolvent tortfeasor, and seek a more equitable solution if, indeed, one is available.[94]

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[92]The only interpretation which can be criticized as being contrary to the intent of the legislature is the comment in *dictum* in Hill v. Metropolitan Trucking Inc., 659 F. Supp. 430, 435 (N.D. Ind. 1987). *See supra* note 21.

[93]It is not clear that the incidence of insolvent and uninsured tortfeasors is as burdensome as it would appear in most academic discussions. For example, in automobile accident injury litigation, such burden is substantially eliminated by the availability of uninsured, or underinsured, motorist coverages. *See* Ind. Code §§ 27-7-5-2 to -6 (Supp. 1987). Nor is there seemingly a burden for tortious injuries arising out of the condition of business premises and business activities, since such businesses rarely are insolvent, and usually are collectible without regard to the existence of insurance. Further, the entire field of product liability injury litigation is not encompassed within the comparative fault act, at least with respect to the theories of strict liability in tort and breach of warranty, and the doctrine of joint and several liability remains applicable in those claims. *See supra* note 38. Finally, medical malpractice actions are not governed by the comparative fault act, and traditional tort doctrines, including that of joint and several liability, remain applicable. Ind. Code § 34-4-33-1(a) (Supp. 1987).

[94]The Kansas Supreme Court concluded that no system of tort reparation is exactly fair:

> Numerous examples of unfairness have been cited by both parties in this case to support their respective positions. The law governing tort liability will never be a panacea. There have been occasions in the past when the bar of contributory negligence and the concept of joint and several liability resulted in inequities. There will continue to be occasions under the present comparative negligence

While there is some bad in the Indiana comparative fault system, there is mostly good. The courts should continue to preserve those basic principles signaled by the legislature, in order to achieve a balanced fairness and a predictable outcome among litigants.

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statute where unfairness will result.

Brown v. Keill, 224 Kan. 195, 204, 580 P.2d 867, 874 (1978). It is claimed that the reallocation provision of the Uniform Comparative Fault Act provides an equitable solution. In the section which deals with the apportionment of damages, the reallocation of the share of an uncollectible tortfeasor is addressed:

> Upon motion made not more than [one year] after judgment is entered, the court shall determine whether all or part of a party's equitable share of the obligation is uncollectible from that party, and shall reallocate any uncollectible amount among the other parties, including a claimant at fault, according to their respective percentages of fault. The party whose liability is reallocated is nonetheless subject to contribution and to any continuing liability to the claimant on the judgment.

Unif. Comparative Fault Act § 2(d), 12 U.L.A. 39, 42 (1979). The Commissioners argue the equity of the solution:

> Reallocation takes place among all parties at fault. This includes a claimant who is contributorily at fault. It avoids the unfairness both of the common law rule at joint-and-several liability, which would cast the total risk of uncollectibility upon the solvent defendants, and of a rule abolishing joint-and-several liability, which would cast the total risk of uncollectibility upon the claimant.

Id. Commissioners' Comment at 43. Certainly, such solution is equitable if the standard of fairness is that all tortfeasors share in the burden created by the uncollectible tortfeasor in shares proportionate to their fault. However, if preeminence is given to the objective of reparation proportionate to fault, then such objective is compromised by making any tortfeasor respond in damages in a sum disproportionate to his share of the total fault. The Indiana legislature clearly assigned such preeminence to such objective, which is inconsistent with the reallocation scheme of the Uniform Comparative Fault Act. *See supra* note 2.

Loan Receipt Agreements Revisited: Recognizing Substance Over Form

Robert W. Strohmeyer, Jr.*

I. Introduction

Loan receipt agreements have long been recognized and accepted by Indiana courts as a means of settling disputes involving multiple tortfeasors.[1] In the traditional sense, a loan receipt agreement is a settlement which by its terms involves the advancement of funds by a tortfeasor to an injured party in the form of a non-interest loan which is *fully* repayable from any recovery obtained by the injured person from any other tortfeasors. In return for the advancement of funds, the injured party promises not to pursue any claim he may have against the settling tortfeasor and/or not to enforce any judgment which might be rendered against the settling tortfeasor.[2] A loan receipt agreement provides the injured party with a guaranteed sum which can be used to pay expenses incurred as a result of the injury and to fund the prosecution of his claim against the non-settling tortfeasors. In return, the settling tortfeasor limits his liability while at the same time retaining the opportunity to recover the amount loaned should the injured party recover from the non-settling tortfeasors. Loan receipt agreements are approved of and encouraged because they tend to settle litigation and provide immediate funds to injured parties.[3]

Like the covenant not to sue and/or execute, and unlike the general release, a loan receipt agreement permits the injured party to settle with

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[1]Northern Ind. Public Service Co. v. Otis, 145 Ind. App. 159, 250 N.E.2d 378 (1969). The earliest Indiana decision which discusses the use of a loan receipt agreement as a tool for settling a claim for personal injuries is Klukas v. Yount, 121 Ind. App. 160, 98 N.E.2d 227 (1951). The loan receipt agreement apparently originated as a device to enable cargo insurers to place funds in the hands of an insured shipper pending litigation against a common carrier responsible for the loss. *See generally* Annotation, *Validity and Effect of "Loan Receipt" Agreement Between Injured Party and One Tortfeasor, For Loan Repayable to Extent of Injured Party's Recovery from a Tortfeasor*, 62 A.L.R.3d 1111 (1975).

[2]American Transport Co. v. Central Ind. Railway Co., 255 Ind. 319, 323, 264 N.E.2d 64, 67 (1970); Fullenkamp v. Newcomer, 508 N.E.2d 37, 39 (Ind. Ct. App. 1987); Ohio Valley Gas, Inc. v. Blackburn, 445 N.E.2d 1378, 1382 (Ind. Ct. App. 1983).

[3]*American Transport*, 264 N.E.2d at 67; *Fullenkamp*, 508 N.E.2d at 39; *Ohio Valley Gas*, 445 N.E.2d at 1382.

one or more joint tortfeasors while at the same time preserving his claim against any nonsettling tortfeasors.[4] A loan receipt agreement insures that the injured party will receive a guaranteed sum no matter what the outcome of the law suit against the nonsettling tortfeasors, because the funds received as a loan by the injured party are not subject to repayment unless the injured party recovers from the nonsettling tortfeasors. Thus, the loan receipt agreement provides the plaintiff with a guaranteed sum free from any chance of loss and any of the uncertainties inherent in all litigation.[5]

It has long been the law and public policy of Indiana that an injured party is entitled to a single recovery for a single wrong, regardless of how many individuals may have contributed to the injury, and that a payment by one joint tortfeasor inures to the benefit of all joint tortfeasors.[6] Therefore, to avoid the possibility that a plaintiff might recover more than his adjudicated damages, courts have consistently held that any funds received by an injured party through settlements must be credited against any judgment entered against the nonsettling tortfeasors.[7] The amount received in settlement is considered satisfaction (whether partial or full) of the judgment, and it is the court's responsibility to credit this amount against the judgment.[8] If the settlement amount exceeds the amount of judgment, the injured party has been fully satisfied and receives nothing from the nonsettling tortfeasor. However, even if the

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[4]A release is an abandonment or relinquishment of a claim for damages, and the unqualified release of one joint tortfeasor acts to release all other joint tortfeasors. On the other hand, covenants not to sue and/or execute and loan receipt agreements are contractual agreements by which a party specifically reserves the right to proceed against other joint tortfeasors. Cooper v. Robert Hall Clothes, Inc., 271 Ind. 63, 64-65, 390 N.E.2d 155, 157 (1979). In determining the nature of the agreement, the court must examine the language of the document to determine the intention of the parties, a task much more difficult than it may first appear as discussed later in this article. *See id.* at 66, 390 N.E.2d at 158.

[5]*Fullenkamp*, 508 N.E.2d at 39; Burkett v. Crulo Trucking Co., 171 Ind. App. 166, 174, 355 N.E.2d 253, 258 (1976).

[6]Sanders v. Cole Municipal Finance, 489 N.E.2d 117, 120 (Ind. Ct. App. 1986), *transfer denied*, September 15, 1986; Barker v. Cole, 396 N.E.2d 964, 970 (Ind. Ct. App. 1979). A recent expression of this policy against over-compensating injured parties can be found in the General Assembly's partial abrogation of the "collateral source rule." *See* Ind. Code §§ 34-4-36-1 to -3 (Supp. 1987). The stated purposes for partially abrogating the rule are to enable the trier of fact to determine the actual amount of loss sustained by an injured party, and to provide that a prevailing party does not recover more than once from all applicable sources for each item of loss sustained. Ind. Code § 34-4-36-1. *See generally* Wilkins, *A Multi-Perspective Critique of Indiana's Legislative Abrogation of the Collateral Source Rule*, 20 Ind. L. Rev. 399 (1987).

[7]*E.g.*, *Sanders*, 489 N.E.2d at 120.

[8]*See, e.g.*, *Sanders*, 489 N.E.2d at 120; *Barker*, 396 N.E.2d at 970.

injured party loses the lawsuit, he still retains the funds received pursuant to the settlement.

Based upon Indiana's policy limiting an injured party's recovery to his adjudicated damages, one would think that if funds received pursuant to a loan receipt agreement were not in fact repayable, then the loan receipt agreement would be similar in effect to a covenant not to sue and/or execute and, as with a covenant, these funds would be subject to set-off against any judgment rendered. However, unlike funds received pursuant to a covenant not to sue and/or execute, Indiana courts have consistently held that amounts received by an injured party pursuant to a loan receipt agreement do not, *under any circumstances*, constitute partial satisfaction of any judgment which might be rendered against the remaining tortfeasors and are not to be credited against the judgment.[9] Inexplicably, Indiana courts have failed to look beyond mere form of the agreement to truly analyze the mechanics of the agreement and to give effect to its substance. Judge Garrard addressed this particular problem in his concurring opinion in *Sanders v. Cole Municipal Finance*.[10] This issue will be the principal focus of this article.[11]

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[9]American Transport Co. v. Central Indiana Railway Co., 255 Ind. 319, 323, 264 N.E.2d 64, 67 (1970); *Sanders*, 489 N.E.2d at 120; Duke's GMC, Inc. v. Erskine, 447 N.E.2d 1118, 1122 (Ind. Ct. App. 1983).

[10]489 N.E.2d at 125 (Garrard, J., concurring). Perhaps this is one of the potential misuses of loan receipt agreements which the court hoped to discourage by "firing a shot across the bow" in Burkett v. Crulo Trucking Co., Inc., 171 Ind. App. 166, 179, 355 N.E.2d 253, 261 (1976).

[11]Of further interest to the trial attorney are the many effects loan receipt agreements have had on both pre-trial and trial practice. Once the loaning defendant has advanced funds to the plaintiff, the defendant's interest in the trial has shifted because now the defendant has become aligned with the plaintiff in that the defendant would benefit through repayment of the loan should the plaintiff recover from the nonsettling defendant. Since no litigable issue remains between the plaintiff and the loaning defendant, the loaning defendant's only purpose for continuing to participate in the trial is to assist the plaintiff in recovering from the nonsettling defendant. For this reason, courts have held that if the loaning defendant is not dismissed from the lawsuit, once the loan receipt agreement is made known, the nonsettling defendant may move for a separate trial and/or introduce the loan receipt agreement into evidence to inform the jury of the loaning defendant's interest in the outcome of the trial. Health & Hospital Corp. of Marion County v. Gaither, 272 Ind. 251, 257, 397 N.E.2d 589, 594 (1979); Burkett v. Crulo Trucking Co., 171 Ind. App. 166, 175, 355 N.E.2d 253, 259 (1976).

Even if the loaning defendant is dismissed from the lawsuit or a separate trial is granted, the loaning defendant or one or more of its agents or representatives may be called to testify at trial. Under these circumstances, the loan receipt agreement is admissible to show the witnesses' interest in the outcome of the trial. Ohio Valley Gas, Inc. v. Blackburn, 445 N.E.2d 1378, 1382 (Ind. Ct. App. 1983); Gray v. Davis Timber and Veneer Corp., 434 N.E.2d 146, 148 (Ind. Ct. App. 1982). If used solely to show bias, the amount of the loan must be deleted from the agreement. Also, if under all

II. The Nature of the Beast

Many settlement agreements labeled as "loan receipt agreements" are in reality "hybrid" agreements containing characteristics of both the loan receipt and the covenant not to sue and/or execute. Many loan receipt agreements used in Indiana practice include "threshold" levels which must be exceeded by any judgment rendered against the non-settling tortfeasor before repayment of the loan begins.[12] If this threshold level is not exceeded, repayment does not occur at all and the injured party retains both the loan amount and the judgment amount. Under these circumstances, the injured party may recover more than the damages adjudicated by the jury. Thus, the settling parties can structure an agreement which precludes any possibility of a set-off against the judgment as a result of settlement funds previously received by the injured party by simply labeling the agreement a "loan receipt agreement." This is true even though by the very terms of the agreement the likelihood of actual repayment is minimal if, in fact, it exists at all. Unless trial courts analyze the substance of this type of agreement a settlement which is not in fact a loan will nonetheless be treated as a loan and the injured party may be over-compensated.

In *Sanders v. Cole Municipal Finance*,[13] the Sanders sued multiple defendants as a result of injuries Mr. Sanders sustained while at his place of employment. Prior to trial, the Sanders entered into settlements with all of the defendants except Cole Municipal Finance. The settlement agreements were in the form of covenants not to sue and/or execute, except for one agreement which was designated as a "loan receipt agreement." All of the agreements reserved the right of the Sanders to proceed against any other individuals potentially liable for the loss.[14] The jury returned a verdict in favor of the Sanders in the amount of $320,000. The trial court then credited against the verdict the amounts the Sanders had received for the covenants not to sue and/or execute. The Sanders had received more through the settlements than the verdict

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the facts and circumstances of the case any statements in the agreement do not constitute fair comment on the subjects covered in the agreement or were drafted for the sole purpose of "manufacturing evidence" they must be deleted before the agreement is admitted. *Ohio Valley Gas*, 445 N.E.2d at 1383. An appropriate instruction limiting the affect of the admission of the terms of the loan receipt agreement into evidence should be requested. *See, e.g.*, Reese v. Chicago, Burlington & Quincy R.R., 55 Ill.2d 356, 364, 303 N.E.2d 382, 387 (1973).

[12] *See, e.g.*, Duke's GMC, Inc. v. Erskine, 447 N.E.2d 1118, 1122 (Ind. Ct. App. 1983); Burkett v. Crulo Trucking Co., 171 Ind. App. 166, 174, 355 N.E.2d 253, 258 (1976).

[13] 489 N.E.2d 117, 119 (Ind. Ct. App. 1986), *transfer denied*, September 15, 1986.

[14] *Id.*

amount, so the trial court entered an order of judgment in favor of the only remaining defendant, Cole Municipal Finance.[15] The Sanders appealed, arguing, among other things, that the court erred in crediting the amounts received for the covenants not to sue and/or execute against the verdict and in entering judgment in favor of Cole.[16]

The appellate court held that the funds received by the Sanders in return for the covenants not to sue and/or execute were properly credited against the judgment rendered against the remaining defendant.[17] As the court noted, the principle behind requiring the credit is that an injured party is entitled to but one satisfaction for a single injury, and the payments by the settling defendants inured to the benefit of the only remaining defendant, Cole.[18] The court further held that the funds received by the Sanders pursuant to the loan receipt agreement were not to be credited against the judgment.[19] These funds were not to be considered as partial satisfaction of the judgment.[20] The court held, however, that it was error for the trial court to enter *judgment* for Cole, for the trial court should have entered judgment for the Sanders in the amount of the verdict and then should have made any necessary set-off against the judgment rather than against the verdict.[21] Because the amount received by the Sanders pursuant to the covenants exceeded the judgment, the judgment was considered fully satisfied without any payment by Cole.[22]

Apparently, the defendant in *Sanders* did not raise the issue of partial satisfaction insofar as the loan receipt agreement was concerned. None of the parties challenged the court's characterization of the agreement as a loan receipt agreement, nor was there any mention of a request by the defendant that the court set-off against the judgment the amount received by the Sanders pursuant to the loan receipt agreement which was not repayable under its terms.[23] The terms of the loan receipt agreement were not disclosed in the majority opinion. However, the terms were disclosed in Judge Garrard's concurring opinion, although it is difficult to discern from the concurring opinion the precise nature

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[15]*Id.* at 119.

[16]*Id.* at 119-20.

[17]*Id.* at 120-21.

[18]*Id.* at 120.

[19]*Id.*

[20]*Id.* at 120, 125.

[21]*Id.* at 124-25.

[22]*Id.* at 125.

[23]It should be noted that since the amounts received by the Sanders pursuant to the covenants exceeded the judgment, crediting the additional funds received pursuant to the loan receipt agreement which were not repayable would not have altered the result and perhaps this is why the issue was not raised.

of the terms for repayment of the loan.[24] It is clear from the opinion, however, that based upon the verdict rendered in the case, a portion of the loan was not in fact repayable.[25] Although concurring with the result reached by the majority, Judge Garrard disagreed with the majority opinion in its analysis of the effect of the Sanders' loan receipt agreement. Judge Garrard's comments bear repeating:

> While the basic concept of such [loan receipt] agreements may be the same, they exist in almost infinite variety as to the terms, conditions and amounts subject to repayment. Certainly, in the extreme an agreement could be constructed with the amount of repayment so small or the conditions so far-fetched that the court might conclude it was in fact something else. That is not my concern.
>
> The cases appear to genuinely adhere to the concept that the plaintiff is entitled to only one satisfaction. I do not disagree. But, if that is so, why should monies received upon a covenant not-to-sue or a covenant not-to-execute be counted toward that satisfaction? According to the recitations of the parties the money is paid *as a consideration for the promise* or to avoid the expense and uncertainty of litigation, not as compensation for injury. Many would deem it silly to allow such a transparent device to alter the substance of what was being done and thereby evade the mandate of a principle we endorse in the law.
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> In point of fact much the same thing occurs in the typical "genuine" loan receipt agreement. . . .
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> Of course, whatever actual amounts they [the Sanders] were obligated to repay were not and should not be treated as "satisfaction." On the other hand it seems inescapable to me that to the extent there was no obligation to repay in fact, there was a partial satisfaction and the law should recognize it.
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> The court in *American Transport Co.* recognized the desirability of permitting loan receipt agreements. That desirability does not appear to me to be hindered by enforcing the rule that amounts received which under the terms of the agreement need not be repaid, constitute a partial satisfaction of a plaintiff's claim.
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> I would therefore also credit against the judgment the amount

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[24]*Sanders*, 489 N.E.2d at 125-26 (Garrard, J., concurring).

[25]The concurring opinion states that the Sanders received $200,000 pursuant to the agreement. They were obligated to repay 25% from the first $400,000 they recovered from Cole and if they recovered more than $400,000 from Cole they were obligated to repay the loan on a dollar for dollar basis for the remaining 75%. *Id.*

> paid under the loan receipt agreement which Sanders had no obligation to repay.[26]

Clearly, Judge Garrard advocates giving effect to substance over form, even though that might require that the trial court take a more detailed look at the agreement constructed by the parties. As in *Sanders*, the true nature of the agreement may not be known until after the verdict has been rendered and the repayment terms have become operative. However, trial courts must scrutinize these agreements if the public policy against over-compensating injured parties is to continue intact.

III. Full or Partial Satisfaction?

As Judge Garrard recognized in *Sanders*, a loan is not a loan when, pursuant to the terms of the agreement, there is no obligation to repay the loan. If an agreement exists in which the "threshold" amount, that is, the amount designated in the agreement which the judgment must exceed before repayment of the loan begins, is so high that counsel can reasonably argue that the injured party has been fully satisfied and, therefore, liability has been discharged as against the remaining defendants, counsel should be permitted to make such an argument.[27] For example, assume that a potential defendant "loans" the injured party $300,000 in return for dismissal of the lawsuit. The terms of the agreement do not require repayment of any portion of the loan amount unless and until the injured party recovers over $300,000 from the nonsettling defendants. The injured party has received $300,000 free and clear of any chance of loss. If the nature of the injured party's damages are such that counsel can reasonably argue that the receipt of $300,000 fully and fairly compensates the injured party, counsel should be permitted to argue to the jury that the injured party has been fully satisfied and that the defendant's liability has been discharged because the injured party has already received $300,000 which is not subject to repayment. The terms of the agreement, including the loan amount and the terms

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[26] *Id.* Illinois courts apparently support Judge Garrard's view. Popovich v. Ram Pipe & Supply Co., 82 Ill. 2d 203, 209-10, 412 N.E.2d 518, 521 (1980); Webb v. Toncray, 102 Ill. App. 3d 78, 80-81, 429 N.E.2d 874, 877 (1981) (set-off resulted in reducing verdict to zero). Loan receipt agreements with "threshold" amounts are designated as "platform loan agreements" by the Illinois courts. *See* Palmer v. Avco Distributing Corp., 82 Ill. 2d 211, 215, 223, 412 N.E.2d 959, 961, 965 (1980).

[27] Trial counsel must consider whether or not he can reasonably argue that the "threshold" amount constitutes full satisfaction in light of the nature of the injuries suffered, the special damages incurred, etc. It might not be wise to argue full satisfaction if the plaintiff's damages greatly exceed the "threshold" amount, for in this instance trial counsel could lose credibility with the jury. Clearly, however, full satisfaction is a compelling argument to make to a jury if the facts support such an argument.

of repayment, clearly become relevant;[28] further, the jury should be instructed as to the manner in which the agreement should be considered in arriving at its verdict.[29]

If counsel chooses not to argue full satisfaction, or if the jury rejects this argument, the issue of partial satisfaction may arise if amounts received pursuant to the agreement are not, in fact, subject to repayment. For example, in the hypothetical loan receipt agreement discussed above, assume that the injured party must repay on the loan only if the judgment exceeds $300,000, in which case the injured party will repay in full any and all amounts received between $300,000 and $350,000, between $400,000 and $450,000, between $500,000 and $550,000, etc. Based upon these repayment terms, the possibility exists that the injured party will recover more than the jury has determined will fully and fairly compensate him for his injuries. For example, if judgment is rendered against a non-settling defendant in the amount of $400,000, the injured party must repay only $50,000 of the judgment amount to the loaning defendant pursuant to the terms of the agreement. Thus, if no set-off is made for funds received by the injured party pursuant to the loan receipt agreement

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[28]The General Assembly's partial abrogation of the "collateral source rule" supports an argument that the trier of fact must be informed of the amount of any funds received by an injured party through any type of settlement.

> In a personal injury or wrongful death action the court *shall* allow the admission into evidence of:
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> (1) proof of collateral source payments, other than:
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> (A) payments of life insurance or other death benefits;
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> (B) insurance benefits for which the plaintiff or members of the plaintiff's family have paid for directly; or
>
> (C) payments made by the state of Indiana or the United States, or any agency, instrumentality, or subdivision thereof, that have been made before trial to a plaintiff as compensation for the loss or injury for which the action is brought;
>
> (2) proof of the amount of money that the plaintiff is required to repay, including workmen's compensation benefits, as a result of the collateral benefits received; and
>
> (3) proof of the cost to the plaintiff or to members of the plaintiff's family of collateral benefits received by the plaintiff or the plaintiff's family.

IND. CODE § 34-4-36-2 (Supp. 1987) (emphasis added).

[29]*See, e.g.*, State v. Ingram, 427 N.E.2d 444, 446 (Ind. 1981). However, in Duke's GMC, Inc. v. Erskine, 447 N.E.2d 1118, 1122 (Ind. Ct. App. 1983), a jury instruction on the issues of full and partial satisfaction was refused, although the loan receipt and agreement was admitted into evidence in its entirety and the defendant had affirmatively pled full and partial satisfaction. The trial court's refusal to instruct the jury on these issues was affirmed by the court of appeals. *Id.* Based on the verdict rendered by the jury and the terms of the agreement, none of the loan amount was subject to repayment so the plaintiff received more than the jury had awarded as damages. *See id.* at 1120.

which are not repayable by the terms of the agreement, the injured party receives $400,000 from the nonsettling defendant as a result of the judgment and $250,000 ($300,000 loan amount minus $50,000 repaid on the loan) from the loaning defendant for a total of $650,000. The injured party has received $250,000 more than the jury has awarded in damages. Had funds not subject to repayment pursuant to the terms of the agreement been credited toward the judgment, the injured party would have received a total of $400,000, the amount of the jury's verdict. In no event would the injured party be left with nothing. Even if the verdict had been against the injured party, he still would have retained the "threshold" amount of the loan which under the hypothetical agreement is $300,000. If the issue of partial satisfaction has been properly raised by the defendant, the court should credit any amounts not subject to repayment pursuant to the terms of the loan receipt agreement against the judgment after the judgment has been entered. This can be done immediately after the judgment is entered or at a hearing held to determine the nature of the agreements and the amount of any credit.[30]

Assuming the issue of full satisfaction has not been argued, the issue of partial satisfaction can be resolved without placing the terms of the agreement before the jury. However, if full satisfaction has been argued, the terms of the agreement will most likely be before the jury, including the terms of repayment. If the jury does not find full satisfaction, the partial satisfaction defense is still available although the court and not the jury should address the issue of partial satisfaction. This is particularly true since the amount to be credited against the judgment may not be known until after the verdict has been rendered and the repayment terms become operable. To avoid the confusion which will likely result if the jury is required to deal with the repayment terms, the jury should be instructed that the court will address the issue of partial satisfaction. Therefore, in a case where full satisfaction is argued, the jury should be instructed that it is to consider the "threshold" payment made to the plaintiff only to the extent that the "threshold" payment constitutes full satisfaction of the plaintiff's claim. If the plaintiff has been fully satisfied, the jury should enter a verdict in favor of the defendant. If, however, the jury finds that the "threshold" amount does not fully satisfy the plaintiff's claim, the jury should be instructed that it is not to consider the loan agreement and its terms in deciding the issue of damages. Instead, it should determine the amount of damages which will fully and fairly compensate the plaintiff for his injuries without reference to the agreement. The jury should be instructed that the court

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[30]*See* Sanders v. Cole Municipal Finance, 489 N.E.2d 117, 123 (Ind. Ct. App. 1986), *transfer denied*, September 15, 1986.

will credit toward the judgment any amounts retained by the plaintiff pursuant to the loan receipt agreement to insure that there is no double recovery.[31]

IV. The Effect of Comparative Fault

It is yet unclear what effect Indiana's Comparative Fault Act[32] will have on the use of loan receipt agreements as a settlement tool. It has been noted that the widespread use of loan receipt agreements has continued even in those states adopting some form of comparative negligence.[33] Because under comparative fault each tortfeasor is liable only for that portion of the plaintiff's damages attributable to his percentage of fault, the concern of having to pay all of an injured party's damages as a result of application of joint and several liability principles has diminished. However, where allocation of fault is hotly contested and the damages are considerable and could potentially fall solely or disproportionately upon one of multiple defendants, plaintiffs and defendants may sometimes find the loan receipt agreement a welcome settlement tool.

Assuming that Indiana's stated public policy of one recompense for a single wrong has survived the adoption of comparative fault,[34] one can legitimately argue for the continued validity of the full and partial satisfaction defenses. These defenses would be available whether the settling party is a defendant or nonparty defendant. Under comparative fault, a defendant may assert as a defense that the damages

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[31]This appears to be the approach taken by the Illinois courts when the amount of the loan and the terms of repayment are disclosed to the jury. The jury is instructed that the loan amount should not be considered in arriving at the verdict because the court will make any set-off necessary for amounts not subject to repayment. *See* Palmer v. Avco Distributing Corp., 82 Ill. 2d 211, 226-28, 412 N.E.2d 959, 967 (1980).

[32]Ind. Code §§ 34-4-33-1 to -14 (Supp. 1987). As defined in the Act, "fault" is:

> any act or omission that is negligent, willful, wanton, or reckless toward the person or property of the actor or others, but does not include an intentional act. The term also includes unreasonable assumption of risk not constituting an enforceable express consent, incurred risk, and unreasonable failure to avoid an injury or to mitigate damages.

Ind. Code § 34-4-33-2. Because the Act does not apply to actions against qualified health care providers, tort claims against governmental entities or governmental employees, strict liability actions, or breach of warranty actions, it is clear that loan receipt agreements will continue in widespread use. Ind. Code §§ 34-4-33-1, -8, -13.

[33]*See* Eilbacher, *Comparative Fault and the Nonparty Tortfeasor*, 17 Ind. L. Rev. 903, 910 n.10 (1984).

[34]The General Assembly's partial abrogation of the "collateral source rule" tends to support this conclusion. *See* Ind. Code §§ 34-4-36-1 to -3 (Supp. 1987).

suffered by the plaintiff were caused in full or in part by a nonparty.[35] This defense is not lost simply because the plaintiff settled with the nonparty defendant. If the amount received by the plaintiff from the settling defendant or nonparty defendant can reasonably be argued as having fully compensated the plaintiff regardless of the assessment of fault, the defendant should be permitted to make this argument in seeking a discharge from liability. Obviously, this situation will seldom be encountered whether under comparative fault or traditional tort principles. However, the result is wholly consistent with the policy of avoiding double recoveries and with the case law discussing full satisfaction.[36]

If the full satisfaction argument cannot be made, partial satisfaction may be appropriate if the settling defendant or nonparty defendant has paid more in settlement to the plaintiff than he should have based upon the fact-finder's allocation of fault. For example, assume that a single plaintiff sues two defendants who name one nonparty defendant, the nonparty having settled with the plaintiff for $50,000.[37] Assume further that the jury assesses the fault of all parties, including the plaintiff and the nonparty, at twenty-five percent each, and awards damages of $100,000. The verdict represents the jury's determination that the plaintiff is only entitled to $75,000 as a result of the fault of other individuals. However, the nonparty has paid in settlement $25,000 more than the jury has assessed as his proportion of the

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[35]IND. CODE § 34-4-33-10 (Supp. 1987). IND. CODE § 34-4-33-2 (Supp. 1987) defines a "non-party" as: "a person who is, or may be, liable to the claimant in part or in whole for the damages claimed but who has not been joined in the action as a defendant by a claimant. A nonparty shall not include the employer of the claimant." As to settlements with nonparties, see generally Eilbacher, *supra* note 33, at 908-11, and Smith & Wade, *Fairness: A Comparative Analysis of the Indiana and Uniform Comparative Fault Acts*, 17 IND. L. REV. 969, 983-85 (1984).

[36]*E.g.*, Bedwell v. DeBolt, 221 Ind. 600, 609, 50 N.E.2d 875, 877 (1943).

[37]It is assumed that any potential defendant who has settled with the plaintiff will have been identified by the nonsettling defendant and pleaded as a nonparty defendant. It is highly unlikely that a defendant will know of a potential nonparty defendant who has settled with the plaintiff and yet not name that individual as a nonparty defendant in order to have that individual's percentage of fault assessed. However, a question arises as to how a settlement with a tortfeasor who is not a defendant or nonparty defendant and whose fault has not been assessed should be treated. Many courts addressing this issue have held that if the settling party is not a party whose fault will be assessed, the nonsettling parties receive credit only for the amount paid by the settling party or provided in the settlement agreement. *See, e.g.*, Woodard v. Holliday, 235 Ark. 744, 750-51, 361 S.W.2d 744, 748-49 (1962); Tucker v. Palmer, 112 Idaho 648, 735 P.2d 959 (1987). Counsel for the defendant should diligently conduct the necessary investigation and discovery to identify potential nonparties in order to meet the requirements of timely pleading of nonparty defenses as required by statute. IND. CODE § 34-4-33-10 (Supp. 1987).

damages based upon the allocation of fault. Although the jury has determined that the plaintiff is entitled to $75,000 as a result of the fault of others, the plaintiff will receive $100,000 total through payment of the judgment and the settlement. In order to avoid over-compensating the plaintiff, the court should reduce the amount to be paid by each of the nonsettling defendants to reflect the nonparty's over-contribution. There are several ways in which this reduction can be accomplished.

The credit could be apportioned among the nonsettling defendants based upon their relative percentages of fault. That is, each nonsettling defendant's contribution is reduced by the amount which results when the over-contribution of the nonparty is multiplied by the ratio of the nonsettling defendant's fault to the total fault of all nonsettling defendants. On the other hand, the court could allocate the over-contribution equally among the nonsettling defendants without any reference to the relative percentages of fault. Under the facts of this hypothetical, the result will be the same. Alternatively, the court could include the plaintiff in the allocation of the settlement funds whether the funds be allocated equally among all parties or based upon the relative percentages of fault. However, including the plaintiff in the allocation could result in an over-payment to the plaintiff. Allocating the over-contribution to the non-settling defendants insures that the plaintiff receives an amount equal to the jury's award and that the plaintiff is not over-compensated.[38] Under comparative fault, the set-off principle applies whether the agreement is a release, covenant not to sue and/or execute, or a loan receipt agreement where the terms of the agreement do not require full repayment. The precise manner in which settlements will be handled by Indiana courts under comparative fault remains to be seen.

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[38]This approach, with any of the variations discussed, is particularly well-suited for Indiana because in most cases the fault of all individuals contributing to the injury, including plaintiffs, defendants, and nonparties, will be assessed. It must be recognized that by using this approach the plaintiff will suffer by settling with a party for an amount less than the jury ultimately assesses as the settling party's percentage of fault. Eilbacher, *supra* note 33, at 911, argues that it should not matter that the plaintiff might realize a windfall by a settlement which results in the plaintiff recovering more than his adjudicated damages, because the plaintiff should voluntarily accept the risk of any windfall or penalty resulting from over- or under-valuing the settlement. *See, e.g.*, Rogers v. Spady, 147 N.J. Super. 274, 277-78, 371 A.2d 285, 287-88 (1977); Pierringer v. Hoger, 21 Wis. 2d 182, 192, 124 N.W.2d 106, 112 (1963). For a discussion of other approaches taken to avoid windfalls and penalties as a result of settlements under comparative negligence, see generally Smith & Wade, *supra* note 35, at 983-85; H. Woods, Comparative Fault, §§ 13.14-.21, at 279-94 (2d ed. 1987), C. Heft & C. Heft, Comparative Negligence Manual, §§ 4.10-.310 (Rev. ed. 1986).

V. Conclusion

As Judge Garrard recognized in his concurring opinion in *Sanders v. Cole Municipal Finance*,[39] much has been learned about loan receipt agreements since they were first introduced in Indiana. Many loan receipt agreements of today would be better classified as "hybrid" agreements because they contain features of both the traditional loan receipt agreement and the covenant not to sue and/or execute. If the public policy of this state is truly "one satisfaction for a single injury," the courts must begin recognizing substance over form when dealing with the various types of loan receipt agreements encountered today and the unlimited resourcefulness of counsel in drafting them. The resourcefulness which resulted in the creation of the loan receipt agreement is now being used to devise agreements that will result in overcompensating an injured party in contravention of Indiana's stated public policy. Courts must now decide whether the resourcefulness of counsel must give way to public policy considerations.

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[39] 489 N.E.2d 117, 125-26 (Ind. Ct. App. 1986) (Garrard, J., concurring), *transfer denied*, September 15, 1986.

Hansen v. Von Duprin: Have the Floodgates Opened to Workmen's Compensation Claims?

CAROLYN W. SPENGLER*

I. INTRODUCTION

A year after its landmark decision in *Evans v. Yankeetown Dock Corporation*[1] the Indiana Supreme Court has rendered another momentous workmen's compensation decision, *Hansen v. Von Duprin*.[2] It is momentous on several counts. First, it found compensable a mental "injury" without an accompanying physical injury.[3] Second, it rejected any requirement that the mental injury be the result of some unusual stress in the employment situation.[4] While the first aspect is significant, if not surprising, the second aspect may represent the most far-reaching impact of *Hansen*—and in cases having nothing to do with mental injuries.

In its move away from the unusualness requirement for physical as well as mental injuries, the Court has abandoned a long-standing line of workmen's compensation cases which provided an "unusualness" rule as a framework for determining the causation requirement of the Indiana Workmen's Compensation Act.[5] *Hansen* also has left in doubt the non-compensability of injuries due to the ordinary wear-and-tear of life under the Act.[6] In the process, it has added to the confusion between two

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[1]491 N.E.2d 969 (Ind. 1986).

[2]507 N.E.2d 573 (Ind. 1987).

[3]By so holding, Indiana joined the majority position on workmen's compensation cases involving mental stimulus causing nervous injury. 1B A. LARSON, THE LAW OF WORKMEN'S COMPENSATION (MB) § 42.23 (1987). The holding is particularly interesting since Indiana still adheres, albeit tenuously, to the "impact rule" in civil negligence cases. *See, e.g.*, Little v. Williamson, 441 N.E.2d 974, 975 (Ind. Ct. App. 1982), *transfer denied* (1983). Although this different treatment of mental injury workmen's compensation claims can be rationalized on the basis of the no-fault, humanitarian character of the statutory scheme, one could speculate that the *Hansen* decision could be a harbinger of a departure from the "impact rule" in Indiana tort law.

[4]The court's refusal to utilize the unusualness test puts it in harmony with the modern trend in workmen's compensation law. *See* 1B A. LARSON, *supra* note 3, at § 42.23(b)(7-661) and (c)(7-670).

[5]*See, e.g.*, United States Steel Corporation v. Dykes, 238 Ind. 599, 154 N.E.2d 111 (1958).

[6]*Cf.* Calhoun v. Hillenbrand Indus., Inc., 269 Ind. 507, 381 N.E.2d 1242 (1978); Lovely v. Cooper Indus. Products, Inc., 429 N.E.2d 274, 281 (Ind. Ct. App. 1982) (Ratliff, J., concurring in result).

requirements that should be very separate—that the injury be accidental and that it arise out of the employment.[7]

Has the supreme court opened the floodgates for workmen's compensation claims? Unless it proceeds to establish some more specific parameters for compensability, the floodgates may indeed be opened. The purpose of this article is to analyze the second aspect of the *Hansen* decision and the path leading to it, to suggest a specific and comprehensive framework to limit compensability consistent with the liberal position now adopted by the supreme court, and to examine briefly some ramifications of the court's current approach.

II. The Hansen and Evans Decisions

The crucial language in *Hansen* is: "Whether the injury is mental or physical, the determinative standard should be the same. The issue is *not* whether the injury resulted from the *ordinary* events of employment. Rather, it is simply whether the injury arose out of and in the course of employment."[8]

The court did concede certain vague limits to compensability:

> This is not to say that compensability is determined by the time of onset of an injury. The mere fact that an injury occurs at work does not, *ipso facto*, render it compensable. The nature of the injury, including an aggravation or triggering of a preexisting injury, must be such that injury or aggravation is shown to 'arise out of and in the course of employment,' that is, to be causally connected with the employment.[9]

However, the supreme court failed to give any guidance for determining when an injury may be said to "arise out of" the employment.

The unusual event/exertion/stress rule,[10] developed as an evidentiary threshold to assure the causal link between an injury and the employ-

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[7]1B A. Larson, *supra* note 3, at §§ 38.82-38.83.

[8]*Hansen*, 507 N.E.2d at 576.

[9]*Id.*

[10]*See, e.g.*, United States Steel Corp. v. Dykes, 238 Ind. 599, 154 N.E.2d 111 (1958). *Dykes* was the cornerstone of the cases adhering to the "unusualness rule." *See* City of Anderson v. Borton, 132 Ind. App. 684, 178 N.E.2d 904 (1961); Rivera v. Simmons, Co., 164 Ind. App. 381, 386-87, 329 N.E.2d 39, 42 (1975); Houchins v. Pierponts, 469 N.E.2d 786, 788 (Ind. Ct. App. 1984). This position was not without its detractors, particularly those lower courts which espoused the "unexpected result" interpretation of "injury by accident." *See, e.g.*, Ellis v. Hubbell Metals Inc., 174 Ind. App. 86, 366 N.E.2d 207 (1977) (using the "unexpected result" theory to determine compensability). The supreme court, however, remained steadfast until now in adhering to the "unexpected" or "untoward event" theory. *See Calhoun*, 381 N.E.2d 1242. When applied to the causation issue as contrasted with the "by accident" issue, the "unexpected event" rule is another expression of the "unusual exertion" rule. *See* Young v. Smalley's Chicken Villa, Inc., 458 N.E.2d 686 (Ind. Ct. App. 1984).

ment,[11] provided that guideline. While this "unusualness" rule may have operated unfairly with respect to those employees whose daily tasks at work were routinely physically demanding, either in level of exertion or on account of repetition, in cases where those day-after-day demands ultimately caused an injury, a "*usual* exertion or stress" rule, unless refined, can result in unwarranted compensability when the usual demands of a particular job are indistinguishable from the demands of ordinary living outside the work place. It seems as if the supreme court arrived at its present position[12] by confusing, prior to *Evans*, the problematic use of the "unusual event" requirement to define "by accident" with the quite different function of the "unusual event/exertion/stress" concept as a standard for legal causation.[13]

To understand the present blurred state of the requisites for compensability, it is necessary to re-examine *Evans* and the successive stages of *Hansen*. When *Evans v. Yankeetown Dock Corp.*, was decided, it appeared to stand for the proposition that, for jurisdictional purposes, "*an* accident" was not the threshold. Rather, the first requisite to jurisdiction, "by accident," was held to be "unexpected injury or death."[14]

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[11]1B A. LARSON, *supra* note 3, § 38.81, at 7-270, 7-271.

[12]This position can only be *implied* from the court's opinion. It is best described as "anti-unusual" since the court has given it no conceptual framework. One can fairly imply that the "usual" events (whatever they may be) of the employment will be a sufficient producing cause for an injury to be found compensable. One can further imply that because of the court's use of "events"—in the plural—in its holding that it will not require that an injury be identified with any specific, single time or place in the employment. Indeed, Sharon Hansen was unable to identify what it was that her supervisor said to her on the fatal day which precipitated her breakdown. *See infra* text accompanying note 17.

[13]Larson emphasizes that "arising out of" is a causation question which has two parts, legal causation and medical causation. Under the legal test, the law must define what kind of exertion or stress satisfies the test of "arising out of the employment." Then, under the medical test, the medical expert must say whether the exertion or stress, having been held legally sufficient to support compensation, in fact caused the physical condition. 1B A. LARSON, *supra* note 3, at § 38.83(a).

[14]Evans v. Yankeetown Dock Corp., 491 N.E.2d 969 (Ind. 1986). As to the nature of this jurisdictional element, the supreme court and the court of appeals were in accord. They differed on whether the phrase "arising out of and in the course of the employment" represented two additional prongs of the jurisdictional element or mere surplusage. The supreme court held they were the former. *Evans*, 491 N.E.2d at 973.

In deciding whether all three jurisdictional requisites to the application of the exclusive remedy rule were present in the *Evans* case, the court readily found the fatal shooting of Evans to be death by accident. *Id.* at 975. It then addressed the other two prongs. It stated that "[a]n injury arises out of the employment when there is a causal relationship between the injury and the employment." *Id.* (citing Donahue v. Youngstown Sheet & Tube Co., 474 N.E.2d 1013 (Ind. 1985)). It found causation in *Evans* because the allegations against the employer were that of breach of duty stemming from the employer/employee

It was in connection with clarifying the nature of this element that the court brought up the controversy concerning "untoward or unexpected event."[15]

A shooting death such as Evans' is not an ordinary kind of occurrence in the work place. Indeed, it may be the *ultimate* unexpected or untoward event. Therefore the analysis of causation in *Evans* did not deal with the kinds of issues which repeatedly arise in the more run-of-the-mill workmen's compensation claims, most notably back, heart attack and repetitive trauma cases. Nevertheless, in *Evans*, in contrast to *Hansen*, the supreme court clearly understood that "by accident" was a distinct element from "arising out of," the former going to the *character* of the injury, the latter pertaining to its *causation*.[16]

The events in *Hansen v. Von Duprin* were uncommon but the issue presented is common to that presented in the garden-variety workmen's compensation claim.[17] *Hansen* involved a string of incidents which eventually resulted in disability due to a nervous condition. Sharon Hansen was subjected to perverse harassment by her supervisor, Jim Hale. Knowing of Hansen's fear of guns due to a gunshot wound inflicted by her former husband several years earlier, Hale callously played various pranks on Hansen which simulated guns or gunshots. These actions made Hansen, who had suffered numerous emotional and physical problems, increasingly nervous and agitated. On October 23, 1979, an unspecified comment by Hale caused Hansen to become so hysterical that she had to leave work and seek medical attention. Her doctor diagnosed her condition as severe anxiety and depressive syndrome. She has been unable to work since on account of her condition.[18]

When she applied to the Industrial Board for workmen's compensation, the full board ruled against her, overturning an award in her

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relationship, relying on 1B A. Larson, The Law of Workmen's Compensation § 11.30 (1983) for the proposition that neutral assaults are considered to be within the scope of workmen's compensation. *Evans*, 491 N.E.2d at 975. It also found, without difficulty, that Evans' death arose in the course of his employment since he had arrived at work at his usual time and was merely pausing for a cup of coffee with fellow employees prior to going to work when he was shot. *Id.* at 976.

[15]*Id.* at 973. *See also* Hansen v. Von Duprin, Inc., 507 N.E.2d 573, 575-76 (Ind. 1987).

[16]*Evans*, 491 N.E.2d 969.

[17]*See, e.g.*, Kerchner v. Kingsley Furniture Co., Inc., 478 N.E.2d 74 (Ind. Ct. App. 1985) (back injury from heavy lifting); Lovely v. Cooper Indus. Products, Inc., 429 N.E.2d 274 (Ind. Ct. App. 1981) (series of blows while operating machinery over period of years as cause of back pain); American Maize Products Co. v. Nichiporchik, 108 Ind. App. 502, 29 N.E.2d 801 (1940) (pre-existing condition aggravated over period of years by concussion from air hammer).

[18]507 N.E.2d at 573-74.

favor by the single member who conducted the hearing. The findings of the single member and the full board were identical except for the full board's additional finding: "It is further found that there is no probative evidence of *an accident* as defined under the Indiana Workmen's Compensation Act."[19] On appeal, the court of appeals followed *Evans* and found that Hansen's anxiety neurosis resulting from Hale's actions "was an unexpected injury and, therefore, fits within the definition of injury by accident."[20]

The second issue of the court of appeals' decision put that court into uncharted waters—whether the Workmen's Compensation Act covers purely mental injuries. This was a novel issue in Indiana.[21] The court of appeals had no difficulty deciding that there was no valid reason to require a physical injury to justify an award for a work-related nervous disorder.[22] What the court of appeals *did* view as difficult and important, was establishing a standard for causal connection between the employment and a claimed mental injury. It stated:

> As one commentator noted:
>
> Rarely does a mental illness result from a single cause. More often than not it results from many causes, including basic defects in the employee's personality, and hence, it is arguable that mental illness is an ailment common to all mankind irrespective of the employer-employee relationship.[23]

The court perceived an analogy in the difficulty presented by workmen's compensation cases involving heart attacks. There, it observed,

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[19] *Id.* at 575 (emphasis added). The Industrial Board's decision was handed down prior to the supreme court's decision in *Evans. Id.*

[20] Hansen v. Von Duprin, Inc., 496 N.E.2d 1349 (Ind. Ct. App. 1986), *vacated*, 507 N.E.2d 573 (Ind. 1987).

[21] *See Hansen*, 507 N.E.2d at 575.

[22] Ironically, in view of the traditionally conservative stance of the Indiana courts, the court of appeals' (and, subsequently, the supreme court's) decision put Indiana at the forefront of the trend on this issue of the compensability of mental injury without physical injury. *See* 1B A. Larson, *supra* note 3, at § 42.23. Many states allow compensation in only two types of cases involving mental illness: (1) physical trauma which produces a mental disorder, and (2) mental stimulus which produces a physical disability. *See* Hansen v. Von Duprin, 496 N.E.2d at 1350, n.1. The appellate court observed that the Indiana Workmen's Compensation Act of 1929, Ind. Code §§ 22-3 (1982 & Supp. 1987) contained no language excluding mental illness and that Indiana courts long permitted compensation awards for neurosis accompanying physical injuries. *Hansen*, 496 N.E.2d at 1350.

[23] *Hansen*, 496 N.E.2d at 1350 (quoting Render, *Mental Illness as an Industrial Accident*, 31 Tenn. L. Rev. 288, 297 (1964)). For a very thoughtful and thorough discussion of this dilemma, see Townsend v. Maine Bureau of Public Safety, 404 A.2d 1014 (Me. 1979).

the rule has been that the claimant must demonstrate that the heart attack was precipitated by some unusual stress related to the employment.[24] For evaluating causation of work-related mental injuries, the appellate court proceeded to espouse what it believed was a sensible standard in an approach adopted by other jurisdictions under which the claimant must establish that the disorder resulted from a situation of greater dimensions than the day-to-day mental stresses and tensions which all employees must experience.[25] Applying this standard, it ruled against Sharon Hansen. While it recognized that Hale's behavior toward Hansen was "ill-considered" and "inappropriate," it did not find the "dimension of his antics," which it characterized as horseplay, to be so great or persuasive as to cause "abnormal anxiety in an employee."[26] It distinguished friction between employee and supervisor from friction which escalates to the point of full-fledged harassment[27] and ultimately found: "Although Hale's conduct did not help Hansen's emotional state, we cannot hold that his actions caused her present anxiety disorder."[28]

The supreme court disagreed, not just with the application of the court of appeals' rule to the facts, but with the rule itself. In explaining its granting transfer, the court stated, "In proposing a rule limiting the compensability of mental injuries to those resulting from stresses '*other* than the day-to-day mental stresses which all employees experience,' the court of appeals would be, in actuality, regressing to the 'untoward event' standard unanimously rejected by this Court in *Evans* . . . ."[29]

What the supreme court here failed to recognize is that the court of appeals was *not* regressing to the "untoward event" problem with which *Evans* dealt. The "untoward event" notion there pertained to defining "by accident," a separate prong of the compensability requirements. In *Hansen* the court of appeals was attempting to find an appropriate legal test for the *causation* element[30] of the Workmen's

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[24]*Id.* at 1351.

[25]Hansen v. Von Duprin, Inc., 496 N.E.2d at 1351. *See also* School Dist. #1 v. Department of Indus. Labor & Human Relations, 62 Wis. 2d 370, 215 N.W.2d 373 (1974).

[26]*Hansen*, 496 N.E.2d at 1351. Arguably, rather than to make those findings itself, the court of appeals should have remanded the case to the Industrial Board for the Board to make the necessary findings of fact under the newly announced principles of law. *See* Lovely v. Cooper Indus. Products, Inc., 429 N.E.2d 274, 278 (Ind. Ct. App. 1981). The only reason the full board found against Hansen was that it determined that there had not been an accident. From the supreme court's rendition of the facts, one might question the correctness of the court of appeals' application of its own rule to the facts.

[27]*Hansen*, 496 N.E.2d at 1351.

[28]*Id.*

[29]Hansen v. Von Duprin Inc., 507 N.E.2d 573, 575 (Ind. 1987).

[30]Larson explains the difference between legal causation and medical causation and the importance of separating them. IB A. LARSON, *supra* note 3, at § 38.83(a), (b) and (h).

Compensation Act expressed by the "arising out of . . . the employment" language. Nothing in *Evans* compelled the conclusion that an "unusual exertion/stress" rule had been rejected as a standard for legal causation as well as for "accidentalness." Only after the supreme court's decision in *Hansen* is it apparent that its rejection of "unusualness" was across the board.

III. The "Causation" Problem

Having rejected any unusualness test, the supreme court failed to articulate any test at all for causation. The most it stated was that the issue was "not whether the injury resulted from the ordinary events of employment."[31] The Court declined to articulate even a "usual exertion rule."[32] As a result, it has left Indiana workmen's compensation law in a vacuum.

Determining what constitutes an injury "arising out of . . . the employment" requires making some kind of distinctions, if, as the court has held, compensability is not to be determined merely by the time of onset. If the supreme court believes it necessary to move away from the "unusual stress or exertion" rule, it should do so by providing some other framework by which to differentiate those injuries which "arise out of and in the course of the employment" from those which do not. The supreme court's decision in *Hansen* is about as helpful in identifying that causation standard as was the famous remark of Justice Stewart in defining what constitutes pornography, "I know it when I see it. . . ."[33]

The supreme court apparently failed to recognize the need for setting a standard for causation. The causation issues were relatively easy in both *Evans* and *Hansen*. The court of appeals in *Hansen* instinctively recognized but, unfortunately,[34] did not elaborate on the reason courts have found it necessary to look for a distinctive feature in the employment demands, environment, or relationships to serve as a standard in deciding the causation issue in certain kinds of workmen's compensation claims. An appropriate distinctive feature operates as a device, or standard of proof, to ensure that injuries which are compensated have an identifiable link with the employment.[35]

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[31]*Hansen*, 507 N.E.2d at 576. This statement has the ring of the "negative pregnant" complained of in Judge White's dissent in Chestnut v. Coca Cola Bottling Co., 145 Ind. App. 504, 512, 251 N.E.2d 575, 579 (1969) (White, J., dissenting).

[32]1B A. Larson, The Law of Workmen's Compensation § 38.31 (1987).

[33]Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring).

[34]It is unfortunate because had the court of appeals elaborated on this problem, the supreme court might have been forced to deal with the issue of a standard for causation.

[35]It should be noted that not all courts have been delighted at the prospect of making such distinctions. The court in Lock-Joint Tube Co., Inc. v. Brown, 135 Ind. App. 386, 393, 191 N.E.2d 110, 114 (1963) stated the "unusual exertion" rule burdened the courts with "the arbitrary, illogical and absurd duty of drawing gossamer lines of distinction."

The search for such a distinctive feature has taken several paths in Indiana workmen's compensation law. In *Haskell & Barker Car Co. v. Brown*,[36] the talisman was whether an aneurysm suffered by a worker resulted from "*a risk reasonably incident to the employment*." The condition in question in *Townsend & Freeman Co. v. Taggart*[37] was sunstroke. There the court looked for *a hazard beyond that of the general public* to determine if the ensuing disability arose out of the employment.

Perhaps the Indiana case which put the need for such a device into the most compelling perspective is *United States Steel Corporation v. Dykes*.[38] In *Dykes*, the employee was afflicted with a diseased heart and coronary system which had deteriorated to a point where it could not withstand the load put on it by his regular work as a grinder, resulting in a fatal heart attack one day at work. The supreme court rejected the arguments that the legislature intended that a heart attack such as the one suffered by Dykes should be considered a "death by accident arising out of and in the course of the employment,"[39] or that it was "what the courts had in mind when they said that if an accident aggravates a pre-existing condition the resulting harm is compensable."[40] It cited a medical journal article which articulated the dilemma in determining causation in heart cases:

> Frequently it is difficult or impossible to evaluate the significance of the particular episode of stress or injury that the disabled person stipulates (claims) as the precipitating cause of his disability. If the event stipulated is clearly unusual and if it was followed immediately by heart (cardiac) failure, the relationship may be reasonably clear. Often the event stipulated is not sufficiently unusual to distinguish it from other nonoccupational stresses that may have occurred about the same time. Thus, it may be alleged that coronary insufficiency or heart failure was precipitated by lifting a 40 lb. box from an overhead shelf. Such an exertion may have been no greater than that of sneezing or straining at stool, either or both events may have had the same relationship to the onset of heart (cardiac) disability as did the stress of lifting the box. In circumstances of this type no one can assert with propriety that any one of these episodes of stress

[36] 17 Ind. App. 178, 117 N.E. 555, 557 (1917) (quoting Bryant v. Fissell, 84 N.J. 76, 77, 86 A. 458, 460 (1913)).

[37] 81 Ind. App. 610, 144 N.E. 556 (1924).

[38] 238 Ind. 599, 154 N.E.2d 111 (1958).

[39] *Id.* at 611, 154 N.E.2d at 118.

[40] *Id.* at 612, 154 N.E.2d at 118.

> was more likely than any other to have provided the excess work load that caused the diseased heart to fail.[41]

Accordingly, the court went on to hold that the mere showing that the employee "was performing his usual routine everyday task when he suffered a heart attack does not establish a right to workmen's compensation because there was no event or happening beyond the mere employment itself."[42] In other words, this is the unusual exertion rule.

The *Dykes* court and others dealing with this problem[43] have attempted to find a way to make the causal relationship between the employment and the disability-injury or death reasonably clear, to distinguish those situations where the work in which the employee was engaged "simply amounted to the ordinary wear and tear of life impinging on the infirmity with which he had been previously afflicted."[44] Furthermore, there is an additional problem with claims involving mental or emotional illness—that the employee may be either feigning or malingering. The court in *Hansen* recognized no such concerns. Moreover, it implicitly has overruled *Dykes*.

If the floodgates are not to be opened, the Indiana Supreme Court needs to address a critical issue—distinguishing between the employment environment and day-to-day living for purposes of legal causation. It purports to recognize that the mere fact that an injury occurs on the job (or that the employee first becomes aware of symptoms of an injury on the job) is not sufficient *ipso facto* to make that injury compensable.[45] To the extent that the supreme court has recognized that there *are* limits to compensability, it is in accord with other jurisdictions which recognize that the purpose of the workmen's compensation schemes is to "protect workers from those injuries which 'in a just sense' relate to employment,"[46] rather than to make the employer a general health and accident insurer.[47] If this employment/day-to-day living distinction is to have any

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[41]*Id.* at 612 n.3 154 N.E.2d 118 n.3 (quoting Moritz, *Coronary Thrombosis*, J.A.M.A. Vol. 156, No. 14, 1306-09 (Dec. 4, 1954).

[42]*Id.* at 613, 154 N.E.2d at 119.

[43]Wolf v. Plibrico Sales & Service Co., 158 Ind. App. 111, 301 N.E.2d 756 (1973), 158 Ind. App., 304 N.E.2d 355, *transfer denied* (1973) (providing a review of the repetitive trauma and back injury cases). *Compare* Holloway v. Madison-Grant United School Corp., 448 N.E.2d 27 (Ind. Ct. App. 1983) *with* Harris v. Rainsoft of Allen County, Inc., 416 N.E.2d 1320, (Ind. Ct. App. 1981).

[44]238 Ind. 599, 612, 154 N.E.2d 111, 118 (1958) (quoting Detenbeck v. General Motors Corp., 309 N.Y. 558, 561, 132 N.E.2d 840, 842 (1956)).

[45]*See supra* text accompanying note 9.

[46]Townsend v. Maine Bureau of Pub. Safety, 404 A.2d 1014, 1019 (Me. 1979).

[47]*Townsend*, 404 A.2d 1014. *See also* School Dist. #1 v. Department of Indus., Labor and Human Relations, 62 Wis. 2d 370, 215 N.W.2d at 373.

meaning in Indiana, then the supreme court needs to state where the line is to be drawn.

The Indiana Occupational Disease Act makes such a distinction. It defines occupational disease—disease arising out of the employment—as:

> [a] . . . disease arising out of and in the course of the employment. Ordinary diseases of life to which the general public is exposed outside of the employment shall not be compensable, except where such diseases follow as an incident of an occupational disease as defined in this section.
>
> [b] A disease shall be deemed to arise out of the employment only if there is apparent to the rational mind, upon consideration of all of the circumstances, a direct causal connection between the conditions under which the work is performed and the occupational disease, and which can be seen to have followed as a natural incident of the work as a result of the exposure occasioned by the employment, and which can be fairly traced to the employment as the proximate cause, and which does not come from a hazard to which workmen would have been equally exposed outside of the employment. The disease must be incidental to the character of the business and not independent of the relation of employer and employee. The disease need not have been foreseen or expected but after its contraction it must appear to have had its origin in a risk connected with the employment and to have flowed from that source as a rational consequence.[48]

While the legislative drafters may have been verbose in their formulation, they made clear the distinction between diseases which were a risk of employment, and hence compensable, and those which were not.[49]

The supreme court has not yet articulated a standard for legal causation of "injury by accident" to replace that standard swept away explicitly or implicitly by *Hansen*. It is not too late for the court to adopt a comprehensive standard which would be consistent with *Evans* and *Hansen* but which would also explicitly recognize that there are injuries, or infirmities, which, although they may have their onset during the employment, are not to be allocated to the employment relationship

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[48]Ind. Code § 22-3-7-10 (Supp. 1987).

[49]One may observe that the difference between a gradual "injury" such as a heart condition and a "disease" becomes very indistinguishable as the courts move further from either the unusual exertion rule or the "unexpected event or mishap" approach. There is no apparent reason why the legal standard for causation should not be the same for both.

for compensation purposes. What makes certain injuries noncompensable must be the nature of the source of the injury, a nature which is so ordinary that it cannot be attributed, fairly, as a risk of the employment. These are injuries or infirmities which have been characterized as due to the ordinary wear-and-tear of life or due to a trivial incident.[50] Where an injury or infirmity is the result of the ordinary wear-and-tear of life or of a trivial incident, there is no justification for imposing the cost of such an injury on the consumer of the product or service which is the object of the employment.[51]

A standard which the Indiana Supreme Court could adopt as the legal standard for causation might be articulated as follows:

> A workman's claim would be compensable if:
>
> (1) an injury occurs at a fixed time and place, is clearly traceable to the employment, and is not caused by a trivial incident, or
>
> (2) the work consists of a type of activity, or a level of exertion, stress or repetitive activity not common to ordinary everyday living which either has a cumulative detrimental effect or aggravates a pre-existing weakness, resulting in disability; or
>
> (3) the worker sustains a compensable occupational disease.

Such a standard would avoid the unexpected event/unexpected result morass which has plagued the courts.[52] It would avoid making distinctions between exertions unusual and usual to a particular employment. It would recognize a clearly work-related event or accident, even a gradual injury, but would distinguish them from ordinary wear and tear and trivial incidents.[53]

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[50]The courts before *Evans* were not hesitant to recognize a trivial incident. *See, e.g.*, Young v. Smalley's Chicken Villa, Inc., 458 N.E.2d 686 (Ind. Ct. App. 1984); Bowling v. Fountain County Highway Dep't, 428 N.E.2d 80 (Ind. Ct. App. 1981); City of Anderson v. Borton, 132 Ind. App. 684, 178 N.E.2d 904 (1961).

[51]*Cf.* Young v. Smalley's Chicken Villa, Inc., 458 N.E.2d 686, 688 (Ind. Ct. App. 1984) (Neal, P.J., concurring); Lovely v. Cooper Indus. Prod., Inc., 429 N.E.2d 274, 280 (Ind. Ct. App. 1982) (Ratliff, J., concurring in result).

[52]*See, e.g.*, Evans v. Yankeetown Dock Corp., 491 N.E.2d 969, 973 n.1 (Ind. 1986).

[53]The Delaware Supreme Court has adopted a similar standard. In Chicago Bridge & Iron Co. v. Walker, 372 A.2d 185, 187 (Del. 1977), it held there were four ways to support an award: (1) the injury occurs at a fixed time and place and is clearly traceable to the employment; (2) unusual exertion aggravates a pre-existing weakness; (3) the worker shows he has an occupational disease; and (4) the work had a cumulative detrimental effect on the employee's physical condition. This last test is broken into two sub-tests: (1) the usual duties of the employment contributed to the condition and (2) the contributing employment factors were present on the day of the injury. *Id.* at 188. *Accord*, Mooney

The proposed standard would fill the causation vacuum left by *Hansen* but there remain some problems once the scope of compensability has been defined. These problems stem generally from the supreme court's abandonment of an "event" concept, creating a "time" problem.[54] When does an injury occur if there is no accident? That in turn depends upon what is defined as an injury.[55]

No Indiana case gives a clear definition of "injury." There are useful formulations from other sources. In his treatise on workmen's compensation, Larson found one of the best general definitions of "injury" in an early Massachusetts case: "In common speech the word 'injury,' as applied to a personal injury to a human being, includes whatever lesion or change in any part of the system produces harm or pain or a lessened facility of the natural use of any bodily activity or capability."[56] Such a definition would be consistent with *Hansen* and *Evans*, as well as prior case law,[57] as long as it was not interpreted to exclude a mental injury.

IV. The "Time" Problem

With the above definition of injury in mind, we turn to some of the "time" problems under the Indiana Workmen's Compensation Act.

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v. Benson Management Co., 466 A.2d 1209, 1212 (Del. 1983).

Formulations which distinguish between the risks of usual employment duties and ordinary wear and tear are common. For instance, the New York rule is that a heart attack is compensable if attributable to an exertion in the employment placing upon the heart a strain greater than the wear and tear of ordinary life. 1B A. Larson, *supra* note 3, at §§ 38.31(c) and 38.64(a). *Cf.* Allen v. Industrial Comm., 729 P.2d 15, 25, n.7 (Utah 1986).

[54]To some extent, the proposed standard perpetuates that problem by including elements which do not have a time and place focus due to the supreme court's rejection of the concept of a singular event as an integral part of the Workmen's Compensation Act. Once such a concept is rejected with respect to causation, it would be inconsistent to bring it back in on other issues.

[55]The statutory definition is a non-definition: " 'injury' and 'personal injury' mean only injury by accident arising out of and in the course of the employment and do not include a disease in any form except as it results from the injury." Ind. Code § 22-3-6-1(e) (Supp. 1986).

[56]1B A. Larson, *supra* note 3, at § 42.11 at 7-577 (quoting *Burns' Case*, 218 Mass. 8, 105 N.E. 601, 603 (1914)). Larson himself articulates personal injury to include "any harmful change in the body" which "need not include physical trauma, but may include such injuries as disease, sunstroke, nervous collapse, traumatic neurosis, hysterical paralysis, and neurasthenia." *Id.* § 42.00 at 7-575. The inclusion of disease in this definition, without limitation, would be incompatible with the statutory definition of injury in Ind. Code § 22-3-6-1(e) (Supp. 1987). *See supra* note 54. The *Burns' Case* formulation is preferable because it gives concrete form to the notion of "harmful" change.

[57]*See, e.g.*, American Maize Products Co. v. Nichiporchik, 108 Ind. App. 502, 29 N.E.2d 801 (1940); E. Rauh & Sons Fertilizer Co. v. Adkins, 126 Ind. App. 251, 129 N.E.2d 358 (1955).

One problem is the notice required of the employee under the notice provision, particularly when the injury results from the cumulative demands of the job and the onset of symptoms is gradual rather than sudden. Indiana Code section 22-3-3-1 provides in pertinent part:

> Unless the employer or his representative shall have actual knowledge of the occurrence of an injury or death at the time thereof or shall acquire such knowledge afterward, the injured employee or his dependents, as soon as practicable after the injury or death resulting therefrom, shall give written notice to the employer of such injury or death . . . .[58]

Another problem relates to the average weekly wage. The time of occurrence of an injury is the determining factor for the applicable maximum weekly wage.[59] A more difficult problem is posed by the statute of limitations for filing a claim. Indiana Code section 22-3-3-3 provides:

> The right to compensation under IC 22-3-2 through IC 22-3-6 shall be forever barred unless within two (2) years *after the occurrence of the accident*, or if death results therefrom, within two (2) years after such death, a claim for compensation thereunder shall be filed with the industrial board; provided, however, that in all cases wherein an accident or death results from the exposure to radiation, a claim for compensation shall be filed with the industrial board within two (2) years from the date on which the employee had knowledge of his injury or by exercise of reasonable diligence should have known of the existence of such injury and its causal relationship to his employment.[60]

Since the supreme court has abandoned any requisite of a discrete event, in many cases there will be *no* accident. If no accident occurs, what event should start the two-year limitation clock ticking? These time problems were lurking in pre-*Evans* cases but were not addressed.[61]

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[58]IND. CODE § 22-3-3-1 (1982).

[59]IND. CODE § 22-3-3-22 (Supp. 1986).

[60]IND. CODE § 22-3-3-3 (Supp. 1987). The language of this section, specifically the reference to "the accident," calls into question the reasoning of the supreme court in Evans v. Yankeetown Dock Corp., 491 N.E.2d 969, 972-73 (Ind. 1986). The court said, *inter alia*: "Likewise, in construing a statute to determine and give effect to the true intent of the legislature, each individual section of a statute must be construed with due regard for all of the other sections of the act . . . ." (citation omitted). *Id.* at 973. *Evans* fails to reconcile the language of IND. CODE § 22-3-3-3 (Supp. 1987) in arriving at its interpretation of "injury by accident." *See also* IND. CODE § 22-3-3-21 (1982)(concerning burial in all cases of death of an employee from an injury by *an* accident); *Id.* § 22-3-4-3 (*accident* reports).

[61]*E.g.*, Ellis v. Hubbell Metals, Inc., 174 Ind. App. 86, 366 N.E.2d 207 (1977); American Maize Products Co. v. Nichiporchik, 108 Ind. App. 502, 29 N.E.2d 801 (1940).

There are a variety of possible approaches to resolving these time problems. Under the Indiana Workmen's Occupational Diseases Act, the limitation period is triggered by the date of death or disablement.[62] The average weekly wage maximum is related to disability or death.[63] The Indiana Workmen's Compensation Act has a special approach to the limitation period when "an accident or death results from the exposure to radiation. . . ."[64] In such a case, the claim must be filed "within two (2) years from the date on which the employee had knowledge of his injury or by the exercise of reasonable diligence should have known of the existence of such injury and its causal relationship to his employment."[65] In some other jurisdictions the specific date on which an injury occurs is the date on which the *disability* manifests itself.[66] In other cases it has been the time of onset of pain occasioning medical attention, even though the level of pain only makes it more difficult, but not impossible, to work.[67]

To the extent that the onset of pain or other symptomatology and disability do not coincide, that onset of pain or symptoms—that is, the point when the employee becomes aware of the deleterious effect of his job demands—should be the triggering event for notice to the employer.[68] The employer should have the opportunity to take appropriate action, such as to modify the employee's job tasks or to obtain preventive medical care.[69]

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[62]Ind. Code § 22-3-7-32 (Supp. 1986). Disablement must occur within two years after the last day of the last exposure of the hazards of the disease, with certain exceptions. *Id.* § 22-3-7-9(f).

[63]Ind. Code § 22-7-7-19 (Supp. 1986).

[64]*Id.* § 22-3-3-3.

[65]*Id.*

[66]*See* 1B A. Larson, *supra* note 3, § 39.50, at 7-350.27.

[67]*Id.* at 7-350.28.

[68]This approach to the notice requirement would be consistent with Ind. Code § 22-3-3-4 (1982), which provides in pertinent part:

> After an injury and prior to an adjudication of permanent impairment, the employer shall furnish or cause to be furnished, free of charge to the employee, an attending physician for the treatment of his injuries, and in addition thereto such surgical, hospital and nursing services and supplies as the attending physician or the industrial board may deem necessary.

This might seem to be an unwarranted expansion of the employer's obligation to provide medical services. However, if the supreme court is determined to make compensable injuries which flow from the usual events of the employment, without requiring a discrete event, then this expansion of the employer's obligation is inevitable. To the extent that early medical attention may avoid later disability, there is a concomitant advantage to the employer.

[69]In Sharon Hansen's case, for example, early notice to a person with appropriate supervisory responsibility (other than Hale, obviously) might have averted her ultimate breakdown, at least from employment-related causes.

However, fashioning the appropriate "time" concepts to trigger the statute of limitations period and to apply to the average weekly wage determinations involves different considerations. The date of onset of pain or symptomatology may be too early to use as a benchmark for the average weekly wage determination or for the beginning of the limitation period, particularly with a gradual injury. If indeed there is an identifiable accident or incident, such as a fall or an unusual exertion, then the date of that occurrence should control, as it has in the past. Where there is no such singular event, however, then the trigger date should be the earlier date of the following: the first date on which the employee's condition disables him or the date of his last exposure to the deleterious condition in the employment from which the injury resulted. This approach would provide a nexus between the injury and the employment status when there is no specific event to pinpoint the time of an injury.

IV. Conclusion

The foregoing discussion of problems raised by the supreme court's current approach to workmen's compensation cases only scratches the surface. It is obvious that when the supreme court rejected any interpretation of "injury by accident" which was limited to "an accident," it headed in a direction which would lead inexorably to further problems of statutory interpretation. This article has dealt with only a few. There certainly will be others.

It may be that some of the problems can be resolved only by the Indiana legislature. There are certainly a few statutory provisions which are difficult to reconcile with the court's position which abandons any vestige of an accident requirement. Certainly the courts have ahead of them a sizeable task in delineating the requirements of the Workmen's Compensation Act to implement the *Hansen* decision.